

ITC

Results beat estimates

Net sales up 14.1% YoY: ITC's net sales for Q2FY10 were above our estimates, increasing by 14.1% YoY to Rs 42.9bn. This was led by a 21.4% YoY and a 19% YoY growth in cigarettes and agri-businesses respectively. Agri-business surprised positively by posting a 9% QoQ growth. FMCG business grew 14% YoY for the quarter. The hotels segment, however, remained under pressure with a 23.8% YoY de-growth and flat growth QoQ. Paper and paperboard segment grew 12.8% YoY. Volume growth for cigarettes stood at 4-5% for the quarter.

EBITDA growth at 37.8% YoY: During Q2FY10, ITC's EBITDA increased 37.8% YoY to Rs 15.4bn, surpassing our estimates. EBITDA margins expanded by a sharp 615bps YoY to 35.8% – the highest in the past three years. EBIT for cigarettes business increased 24.3% YoY, translating into a 135bps EBIT margin expansion to 56.9% for the segment. EBIT margin for hotels, however, was severely impacted on account of economic slowdown (down 12 percentage points to 18.1%) with its EBIT de-growing 54.1% YoY. For the paper segment, margins improved 610bps to 23.6%. Margins for the agri-business continued to trend upwards and improved 810bps YoY to 16.9% during the quarter; the segment's EBIT increased 128% YoY.

Costs impacting margins

% of sales	Q2FY10	Q2FY09
Material costs	40.0	41.1
Staff costs	5.6	6.3
Other operating costs	18.5	22.9
EBITDA margins	35.8	29.7

Source: RHH, Company

Adj. PAT growth at 25.8% YoY: Adj. PAT beat our estimates and increased 25.8% YoY to Rs 10.1bn. Adjusted PAT growth, however, was lower than EBITDA growth on account of a 42.3% YoY dip in other income to Rs 1.2bn.

Valuation: ITC trades at a P/E of 24.8x and 21.7x, and an EV/EBITDA of 16.4x and 14.3x, on FY10E and FY11E respectively. In view of the better-than-expected performance, we are upgrading our earnings estimates by 1.6% each for FY10 and FY11. Our SOTP model values the cigarettes business at 18x P/E, FMCG business at 3x gross sales, papers at 6x EV/EBITDA, hotels at 16x P/E, and agri-business at 1x gross sales (on FY11E). We maintain Hold on the stock and recommend buying on declines. Our target price stands revised to Rs 263 from Rs 237 earlier.

Financial highlights

(Rs mn)	FY08	FY09E	FY10E	FY11E
Revenue	146,591	163,323	184,977	207,362
Growth (%)	13.9	11.4	13.3	12.1
Adj net income	31,781	33,596	39,437	45,186
Growth (%)	13.7	5.7	17.4	14.6
FDEPS (Rs)	8.4	8.9	10.5	12.0
Growth (%)	13.7	5.7	17.4	14.5

Profitability and return ratios

(%)	FY08	FY09E	FY10E	FY11E
EBITDA margin	31.2	31.1	31.8	32.6
EBIT margin	27.9	27.5	28.8	29.6
Adj PAT margin	21.7	20.6	21.3	21.8
ROE	27.7	25.5	26.4	26.6
ROIC	27.7	25.7	27.6	29.9
ROCE	27.2	25.2	26.0	26.3

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 260	Rs 263	HOLD	LOW

BSE	NSE	BLOOMBERG
500875	ITC	ITC IN

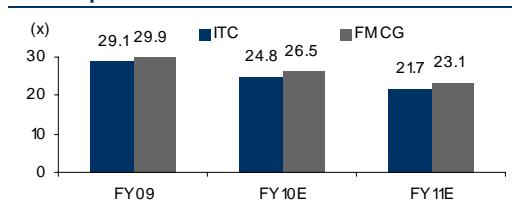
Company data

Market cap (Rs mn / US\$ mn)	978,172 / 21,027
Outstanding equity shares (mn)	3,780
Free float (%)	67.8
Dividend yield (%)	1.8
52-week high/low (Rs)	263 / 132
2-month average daily volume	5.570162

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
ITC	260	11.9	12.1	36.6
Sensex	16,811	0.5	10.4	51.0

P/E comparison



Valuation matrix

(x)	FY08	FY09E	FY10E	FY11E
P/E @ CMP	30.8	29.1	24.8	21.7
P/E @ Target	31.2	29.5	25.1	21.9
EV/EBITDA @ CMP	21.2	19.1	16.4	14.3





Result highlights

Fig 1 - Actual vs. estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	42,926	39,891	7.6
EBITDA	15,374	12,558	22.4
Adj net income	10,099	8,695	16.1
FDEPS (Rs)	2.67	2.30	16.1

Source: RHH

Fig 2 - Quarterly performance

(Rs mn)	Q2FY10	Q2FY09	% Chg YoY	Q1FY09	% Chg QoQ
Revenue	42,926	37,633	14.1	40,827	5.1
Expenditure	27,552	26,473	4.1	27,456	0.3
Operating profit	15,374	11,160	37.8	13,371	15.0
Other income	1,211	2,098	(42.3)	1,378	(12.1)
Interest	181	28	552.5	58	210.6
Depreciation	1,484	1,340	10.7	1,516	(2.1)
PBT	14,920	11,891	25.5	13,175	13.2
Tax	4,821	3,864	24.8	4,388	9.9
PAT	8,695	8,027	8.3	8,787	(1.0)
EBITDA margin (%)	35.8	29.7	615 bps	32.8	305 bps
FDEPS (Rs)	2.30	2.13	7.8	2.33	(1.2)

Source: Company, RHH

Fig 3 - Revised estimates

Key parameters (Rs mn)	FY10E			FY11E		
	Old	New	% Chg	Old	New	% Chg
Revenue	184,997	184,977	0.0	207,362	207,362	0.0
EBITDA	57,921	58,846	1.6	66,540	67,577	1.6
EBITDA margin (%)	31.3	31.8	50 bps	32.1	32.6	50 bps
Net profit	38,818	39,437	1.6	44,491	45,186	1.6
FDEPS (Rs)	10.32	10.48	1.6	11.82	12.01	1.6

Source: RHH

Results above estimates due to higher growth in cigarettes and agri businesses

Net sales up 14.1% YoY led by a 21.4% YoY growth in cigarettes and 19% YoY growth in agri business

EBITDA margins expand 615bps led by margin improvement in cigarettes, paper, and agri businesses

Estimates revised on account of better-than-expected operating performance in cigarettes and agri businesses



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
Revenues	146,591	163,323	184,977	207,362
Growth (%)	13.9	11.4	13.3	12.1
EBITDA	45,681	50,725	58,846	67,577
Growth (%)	11.2	11.0	16.0	14.8
Depreciation & amortisation	4,729	5,809	5,570	6,141
EBIT	40,952	44,916	53,276	61,436
Growth (%)	10.3	9.7	18.6	15.3
Interest	63	187	182	215
Other income	5,862	5,120	5,768	6,221
EBT	46,751	49,849	58,862	67,442
Income taxes	14,970	16,254	19,424	22,256
Effective tax rate (%)	32.0	32.6	33.0	33.0
Extraordinary items	-	-	-	-
Min into / inc from associates	361	471	485	510
Reported net income	31,577	33,248	39,082	44,816
Adjustments	(204)	(348)	(355)	(370)
Adjusted net income	31,781	33,596	39,437	45,186
Growth (%)	13.7	5.7	17.4	14.6
Shares outstanding (mn)	3,762.2	3,762.2	3,762.2	3,763.2
FDEPS (Rs) (adj)	8.4	8.9	10.5	12.0
Growth (%)	13.7	5.7	17.4	14.5
DPS (Rs)	3.5	3.8	4.7	5.4

Cash flow statement

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
Net income + Depreciation	35,168	38,727	44,470	50,742
Non-cash adjustments	(641)	586	2,109	2,269
Changes in working capital	(2,741)	(2,040)	(7,400)	(3,658)
Cash flow from operations	31,786	37,273	39,179	49,353
Capital expenditure	(23,184)	(17,519)	(8,562)	(11,000)
Change in investments	135	(305)	-	-
Other investing cash flow	1,467	1,535	-	-
Cash flow from investing	(21,582)	(16,288)	(8,562)	(11,000)
Issue of equity	446	448	-	-
Issue/repay debt	98	(261)	822	-
Dividends paid	(11,698)	(13,387)	(14,951)	(17,891)
Other financing cash flow	(2,148)	(2,434)	(3,017)	(3,457)
Change in cash & cash eq	(3,097)	5,350	13,471	17,006
Closing cash & cash eq	7,768	13,184	26,655	43,661

Economic Value Added (EVA) analysis

Y/E March	FY08	FY09	FY10E	FY11E
WACC (%)	14.6	14.3	14.3	14.3
ROIC (%)	27.7	25.7	27.6	29.9
Invested capital (Rs mn)	110,883	124,535	133,912	141,307
EVA (Rs mn)	14,459	14,161	17,780	21,997
EVA spread (%)	13.0	11.4	13.3	15.6

Balance sheet

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
Cash and cash eq	7,768	13,183	26,655	43,661
Accounts receivable	8,794	8,036	10,136	11,362
Inventories	42,683	47,943	53,262	59,470
Other current assets	14,095	15,959	20,347	22,810
Investments	26,079	25,071	25,071	25,071
Gross fixed assets	95,992	112,559	123,552	135,552
Net fixed assets	64,425	75,856	81,280	87,139
CWIP	11,565	12,431	10,000	9,000
Intangible assets	2,203	2,802	2,802	2,802
Deferred tax assets, net	(5,436)	(8,606)	(9,690)	(10,933)
Other assets	4	3	3	3
Total assets	172,180	192,679	219,866	250,385
Accounts payable	28,837	31,204	35,419	41,359
Other current liabilities	871	943	1,070	1,249
Provisions	16,212	17,252	20,602	23,605
Debt funds	2,249	1,867	2,689	2,689
Other liabilities	1,132	1,132	1,132	1,132
Equity capital	3,769	3,774	3,774	3,774
Reserves & surplus	119,109	136,507	155,181	176,576
Shareholder's funds	122,878	140,282	158,955	180,351
Total liabilities	172,180	192,679	219,866	250,385
BVPS (Rs)	32.7	37.3	42.3	47.9

Financial ratios

Y/E March	FY08	FY09	FY10E	FY11E
Profitability & Return ratios (%)				
EBITDA margin	31.2	31.1	31.8	32.6
EBIT margin	27.9	27.5	28.8	29.6
Net profit margin	21.7	20.6	21.3	21.8
ROE	27.7	25.5	26.4	26.6
ROCE	27.2	25.2	26.0	26.3
Working Capital & Liquidity ratios				
Receivables (days)	20	19	18	19
Inventory (days)	252	259	258	261
Payables (days)	164	171	170	178
Current ratio (x)	2.5	2.6	3.0	3.2
Quick ratio (x)	0.6	0.7	0.3	0.3
Turnover & Leverage ratios (x)				
Gross asset turnover	1.7	1.6	1.6	1.6
Total asset turnover	0.9	0.9	0.9	0.9
Interest coverage ratio	652.1	240.3	292.4	285.6
Adjusted debt/equity	0.0	0.0	0.0	0.0
Valuation ratios (x)				
EV/Sales	6.6	5.9	5.2	4.7
EV/EBITDA	21.2	19.1	16.4	14.3
P/E	30.8	29.1	24.8	21.7
P/BV	8.0	7.0	6.2	5.4



Quarterly trend

Particulars	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Revenue (Rs mn)	37,633	38,333	38,918	40,827	42,926
YoY growth (%)	15.0	10.9	(1.1)	4.7	14.1
QoQ growth (%)	(3.5)	1.9	1.5	4.9	5.1
EBITDA (Rs mn)	11,160	13,527	12,627	13,371	15,374
EBITDA margin (%)	29.7	35.3	32.4	32.8	35.8
Adj net income (Rs mn)	8,027	9,032	8,090	8,787	10,099
YoY growth (%)	4.1	8.7	10.0	17.4	25.8
QoQ growth (%)	7.2	12.5	(10.4)	8.6	14.9

DuPont analysis

(%)	FY07	FY08	FY09E	FY10E	FY11E
Tax burden (Net income/PBT)	68.7	68.0	67.4	67.0	67.0
Interest burden (PBT/EBIT)	109.6	114.2	111.0	110.5	109.8
EBIT margin (EBIT/Revenues)	28.8	27.9	27.5	28.8	29.6
Asset turnover (Revenues/Avg TA)	91.8	91.2	89.5	89.7	88.2
Leverage (Avg TA/Avg equitiy)	141.1	140.2	138.6	137.9	138.6
Return on equity	28.1	27.7	25.5	26.4	26.6

Company profile

ITC is India's leading cigarette player with a ~80% market share by value. It has a leadership position in every segment of the market, led by significant investments in marketing, distribution, product design, innovation, manufacturing technology and quality. ITC's distribution reach is one of the largest in India. The FMCG business has a retail network of over 2mn retailers in the country, ranging from premium outlets in metros to small shops in the interiors of rural India.

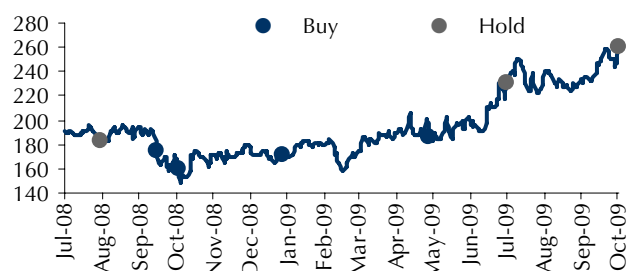
Shareholding pattern

(%)	Mar-09	Jun-09	Sep-09
Promoters	32.2	32.2	32.2
FIs	13.6	13.7	13.1
Banks & FIs	37.7	37.3	37.7
Public	16.5	16.8	17.0

Recommendation history

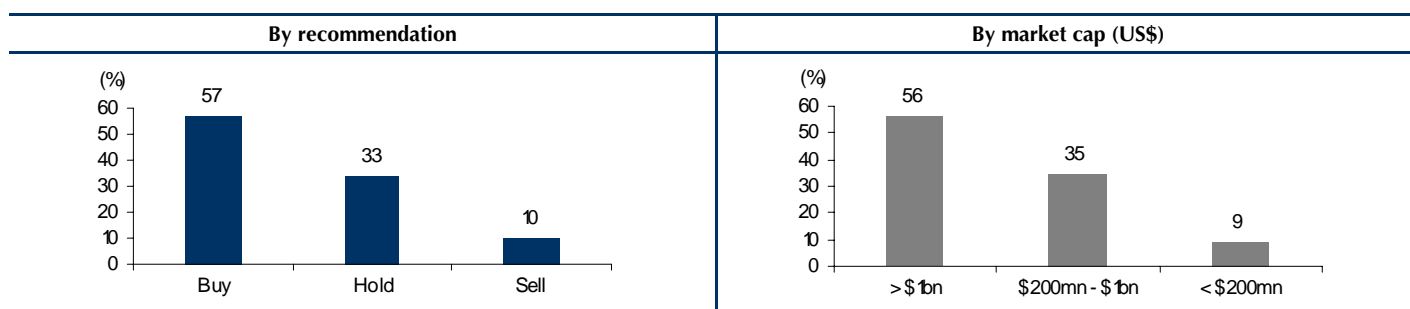
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	183	220	Hold
10-Oct-08	Company Update	174	220	Buy
27-Oct-08	Results Review	155	220	Buy
20-Jan-09	Results Review	171	209	Buy
22-May-09	Results Review	183	209	Buy
23-Jul-09	Results Review	230	237	Hold
24-Oct-09	Results Review	260	263	Hold

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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