BUY

ITC Ltd (Q3 FY08)

January 21, 2008

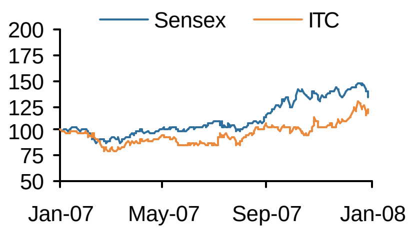
Stock data

Sensex:	19,014
CMP (Rs):	213
Target price (Rs):	264
Upside (%):	24.3
52 Week h/l (Rs):	239/130
Market cap (Rs cr)	80,080
6m Avg vol BSE&NSE ('000 nos):	7,766
No of o/s shares (mn):	3,766
FV (Rs):	1
Bloomberg code:	ITC IN
Reuters code:	ITC.BO
BSE code:	500875
NSE code	ITC

Shareholding pattern

December 2007	(%)
Promoters	-
Foreign	47.4
Institutions	37.6
Non promoter corp hold	2.3
Public & others	12.7

Share price trend



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- Revenues slightly below expectations at Rs35bn, up 11% yoy led by 7.6% increase in cigarettes sales.
- Lower raw material cost restricts margin erosion.
- Higher treasury income drives net profit growth.
- Expect revenue and net profit CAGR of 17.7% and 17% respectively over the next two years. Maintain BUY with a target price of Rs264, upside of 24%.

Financial highlights

Period to	12/07	12/06	Growth	12/07	12/06	Growth
(Rs mn)	(3)	(3)	(%)	(9)	(9)	(%)
Gross sales	54,893	49,936	9.9	159,692	143,651	11.2
Excise duty	(20,313)	(18,789)	8.1	(59,440)	(55,649)	6.8
Net sales	34,580	31,147	11.0	100,252	88,001	13.9
Expenditure	(22,583)	(20,319)	11.1	(66,659)	(57,740)	15.4
Operating profit	11,997	10,828	10.8	33,593	30,261	11.0
Other income	1,374	698	96.9	4,472	2,342	90.9
Interest	(18)	9	-	(19)	(33)	(42.6)
Depreciation	(1,097)	(921)	19.2	(3,170)	(2,707)	17.1
PBT	12,256	10,614	15.5	34,876	29,863	16.8
Tax	(3,948)	(3,440)	14.8	(11,032)	(9,370)	17.7
PAT	8,307	7,174	15.8	23,845	20,493	16.4
OPM (%)	34.7	34.8	-	33.5	34.4	-
Equity, F.V-Re1	3,766	3,760	-	3,766	3,760	-
EPS (Rs) annualized	8.8	7.6	-	8.4	10.9	-
P/E (x), CMP-Rs213	24.1	-	-	25.2	-	-

Source: Company, India Infoline Research

Revenues below expectations, some revival in cigarette growth

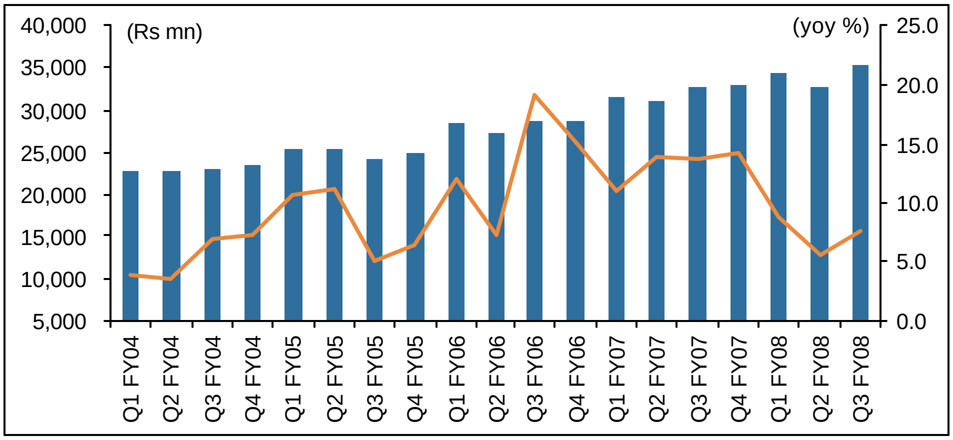
ITC recorded 11% yoy growth in revenues at Rs34.6bn below our expectations of Rs35.6bn during Q3 FY08. The core cigarette segment recorded 7.6% yoy growth at Rs35.3bn despite higher excise burden. The Government had increased excise duty by ~6% in the current fiscal. We believe the cigarette volume decline during the quarter was below 2%. The non-cigarette businesses recorded 12.2% yoy growth at Rs22.4bn driven by strong 50% yoy growth in FMCG (led by branded packaged foods - 60%, biscuits – 58%, confectionary – 38%, lifestyle retailing - 26%), 11.2% yoy growth in paper and packaging and 11.4% yoy rise in hotels' segment. Revenues from the agri segment, however, declined by 9.4% yoy to Rs6.6bn due to restrictions on the export of non-basmati rice.

Segmental break-up

Segments	Q3 FY08				9M FY08			
(Rs mn)	Revenues	yoy (%)	EBIT	yoy (%)	Revenues	yoy (%)	EBIT	yoy (%)
Cigarettes	35,294	7.6	9,611	16.0	102,426	7.4	27,640	13.7
FMCG - others	6,554	50.1	(645)	38.7	17,847	48.0	(1,456)	(5.2)
Hotels	3,136	11.4	1,377	16.3	7,609	11.7	2,680	14.7
Agri business	6,629	(9.4)	278	28.1	27,903	4.9	922	(19.8)
Paper & packaging	6,040	11.2	1,183	13.6	17,447	11.4	3,304	3.4
Total	57,653	9.4	11,804	15.0	173,232	10.7	33,090	12.4

Source: Company, India Infoline Research

Some revival in cigarette growth

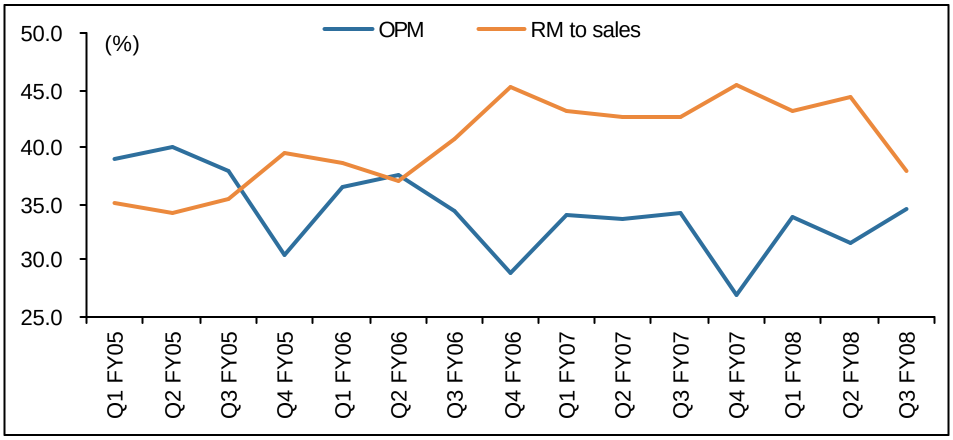


Source: Company, India Infoline Research

Drop in raw material cost restricts margin erosion

Operating margins for the quarter were almost flat at 34.7%, sharp 370bps drop in raw material cost restricted further margin erosion. With higher revenue contribution from low-margin businesses and rising raw material cost (on account of increasing contribution from the agri business), we expect operating margins to remain under pressure in FY08.

OPM Vs RM to sales



Source: Company, India Infoline Research

EBIT margins in the cigarette segment recorded sharp 200bps expansion while hotels segment recorded 190bps expansion in margins. Margins in the agri business expanded by 120bps on account of 37% rise in leaf tobacco exports. However, loss in the FMCG business was higher at Rs645mn compared to Rs465mn in Q3 FY07.

EBIT margins

Segment	Q3 FY08	Q3 FY07	Inc/Dec	9M FY08	9M FY07	Inc/Dec
Cigarettes	27.2	25.3	2.0	27.0	25.5	1.5
FMCG – others	(9.8)	(10.6)	0.8	(8.2)	(12.7)	4.6
Hotels	43.9	42.0	1.9	35.2	34.3	0.9
Agri business	4.2	3.0	1.2	3.3	4.3	(1.0)
Paper & packaging	19.6	19.2	0.4	18.9	20.4	(1.5)

Source: Company, India Infoline Research

Higher other income drives net profit

Net profit for the quarter surpassed our expectations of Rs8bn by recording 15.8% yoy growth at Rs8.3bn aided by higher treasury income (of Rs1.4bn compared to Rs698mn in Q3 FY07). We expect ITC to record revenue and net profit CAGR of 17.7% and 17% respectively over the next two years.

Maintain Buy with a revised price target of Rs264, upside of 24%

Despite higher excise burden and sharp price hike we expect ITC to have recorded a decline of less than 2% in cigarette volumes during the quarter. We believe the higher prices to get successfully absorbed by the industry and ITC's cigarette volume decline would significantly reduce in the coming quarters. We expect the company to record flat volume growth during FY08. Outlook for the non-cigarette businesses such as hotels and paper remains positive with continued demand buoyancy. The other FMCG businesses are also expanding rapidly, while losses are being gradually curtailed. With the entry into the personal care category, we expect ITC to become a tough competitor for HUL and GCPL, given its strong distribution network in the rural (~6,400+ e-choupals and 21 Choupal Saagars) and urban markets. Also, strong cash flows from cigarette business can be invested in advertising heavily to build the personal care portfolio in the initial stage. At the current market price of Rs213, the stock is trading at 18.5x FY10E EPS of Rs11.5 per share. We maintain BUY on the stock with a revised price target of Rs264, an upside of 24%.