



ITC

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,701	ITC IN
	REUTERS CODE
S&P CNX: 2,584	ITC.BO

24 October 2008

Buy

Rs159

Previous Recommendation: Buy

Equity Shares (m)	3,762.2
52-Week Range	239/151
1,6,12 Rel. Perf. (%)	18/23/41
M.Cap. (Rs b)	598.2
M.Cap. (US\$ b)	12.0

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
03/07A	121,643	27,000	7.2	13.2	22.0	5.7	25.9	35.4	4.6	14.0
03/08A	139,475	31,201	8.3	15.6	19.1	5.0	25.9	35.8	4.0	12.7
03/09E	168,933	33,878	9.0	8.6	17.5	4.3	24.7	34.6	3.3	11.2
03/10E	203,738	39,351	10.5	16.2	15.1	3.8	24.9	35.3	2.7	9.5

- ITC's 2QFY09 results were in line with our expectations. The company posted a PAT of Rs8b (v/s our estimate of Rs7.9b), up 4.1%. Reported sales at Rs38b (v/s our estimate of Rs39b) were up 15% YoY. EBITDA was Rs11.1b; margins declined 180bp to 29.7% due to 36% increase in staff cost and 41% increase in other expenditure.
- Cigarette volumes declined 2% (2.25% in 1HFY09) on 75-80% conversion in the plains segment. Cigarette sales grew 10.9%; PBIT grew 16.6%, as margins expand by 135bp. Management expects margins to improve further due to full impact of price increase (5-6%) in the coming quarters.
- New FMCG business sales grew 29.4% to Rs7.6b while PBIT losses increased 219% to Rs1.16b (Rs1.22b in 1QFY09); PBIT margins improved 230bp QoQ but declined 913bp YoY. Branded foods reported 24% increase in sales in a highly inflationary environment; customer acceptability is improving for the personal care segment. Management has guided new FMCG business losses of Rs4b in FY09 (Rs2.4b loss in 1HFY09).
- Paper & paperboards reported 22.6% increase in sales and 2.6% decline in PBIT, as margins declined by 420bp. Increase in depreciation on new writing paper unit and sharp increase in input prices impacted margins. Management has guided increase in profit margins due to stabilization of pulp facility (122,000 ton) and decline in coal prices.
- Hotel business reported 9.7% increase in sales and 4.2% increase in PBIT, as margins declined by 158bp. Management has guided for lower sales and profit growth due to global melt down.
- ITC has been facing considerable headwinds in the cigarette business in the past couple of years. 75-80% filter cigarette conversion and expansion is positive. New FMCG is expected to remain in investment mode in the medium term. Hotels business is likely to witness pressure on sales and profits while paper business should bounce back in the coming quarters. The stock trades at 17.5x FY09E EPS of Rs9 and 15.1x FY10E EPS of Rs10.5. We maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	33,252	32,734	34,580	39,344	38,997	37,633	42,100	50,203	139,475	168,933
YoY Change (%)	16.7	13.4	11.0	13.5	17.3	15.0	21.7	27.6	14.7	21.1
Total Exp	21,977	22,414	22,583	28,897	27,726	26,473	27,800	37,423	95,436	119,422
EBITDA	11,276	10,320	11,997	10,447	11,271	11,160	14,300	12,780	44,039	49,511
Margins (%)	33.9	31.5	34.7	26.6	28.9	29.7	34.0	25.5	31.6	29.3
Depreciation	1,010	1,062	1,097	1,215	1,261	1,340	1,280	1,349	4,385	5,230
Interest	-8	9	18	27	14	28	30	28	46	100
Other Income	1,016	2,083	1,374	1,637	1,144	2,098	1,250	1,002	6,109	5,494
PBT	11,289	11,331	12,256	10,842	11,140	11,890	14,240	12,405	45,718	49,675
Tax	3,461	3,623	3,948	3,485	3,653	3,864	4,550	3,730	14,517	15,797
Rate (%)	30.7	32.0	32.2	32.1	32.8	32.5	32.0	30.1	31.8	31.8
Reported PAT	7,829	7,709	8,307	7,357	7,487	8,027	9,690	8,675	31,201	33,878
YoY Change (%)	20.0	13.4	15.8	13.1	-4.4	4.1	16.6	17.9	15.4	8.6
Adjusted PAT	7,829	7,709	8,307	7,357	7,487	8,027	9,690	8,675	31,201	33,878
YoY Change (%)	20.0	13.4	15.8	13.1	-4.4	4.1	16.6	17.9	15.6	8.6

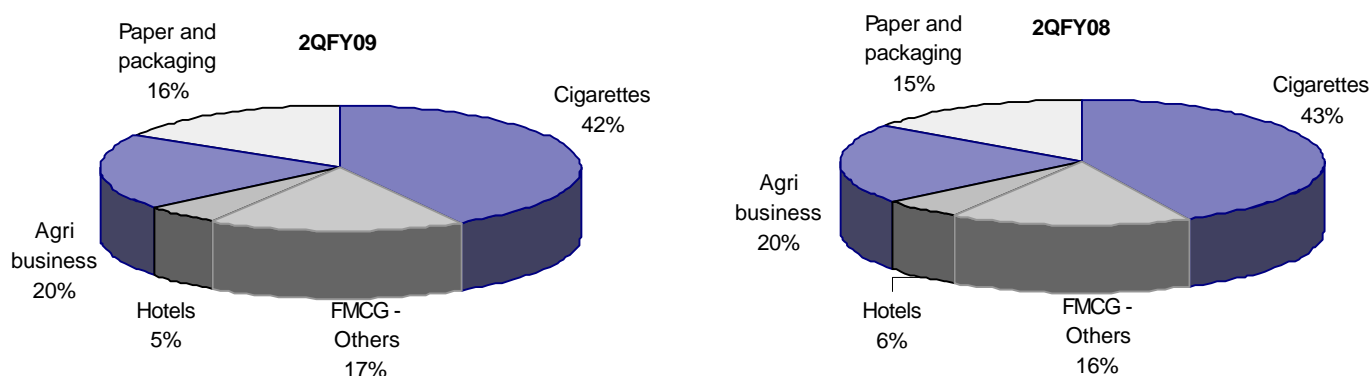
E: MOST Estimates

SEGMENTAL PERFORMANCE

ITC - SEGMENTAL	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09
Sales Growth %, YoY										
Cigarettes	11.1	13.9	13.8	14.3	8.9	5.5	7.6	8.8	5.7	10.9
FMCG - Others	79.6	65.9	67.6	63.1	50.8	43.3	50.1	50.3	27.9	29.4
Hotels	35.3	30.5	28.5	15.6	11.3	12.5	11.4	11.5	17.3	10.1
Agri business	47.4	86.6	19.5	15.5	27.6	-14.7	-9.4	28.1	32.3	16.7
Paper and packaging	8.8	11.1	11.0	12.2	4.9	17.7	11.2	16.2	23.9	22.6
EBIT Margin										
Cigarettes	25.8	25.4	25.3	22.5	27.3	26.4	27.2	24.3	26.4	27.8
FMCG - Others	-16.2	-12.0	-10.6	-9.7	-8.2	-6.2	-9.8	-16.0	-17.7	-15.3
Hotels	29.0	28.8	42.0	38.5	29.0	29.2	43.9	42.1	32.9	27.6
Agri business	4.2	5.3	2.8	0.9	3.8	1.3	4.2	3.4	4.2	8.8
Paper and packaging	20.9	21.2	19.2	18.2	16.5	20.4	19.6	19.8	18.9	16.2

Source: Company/Motilal Oswal Securities

SALES MIX



Source: Company/Motilal Oswal Securities

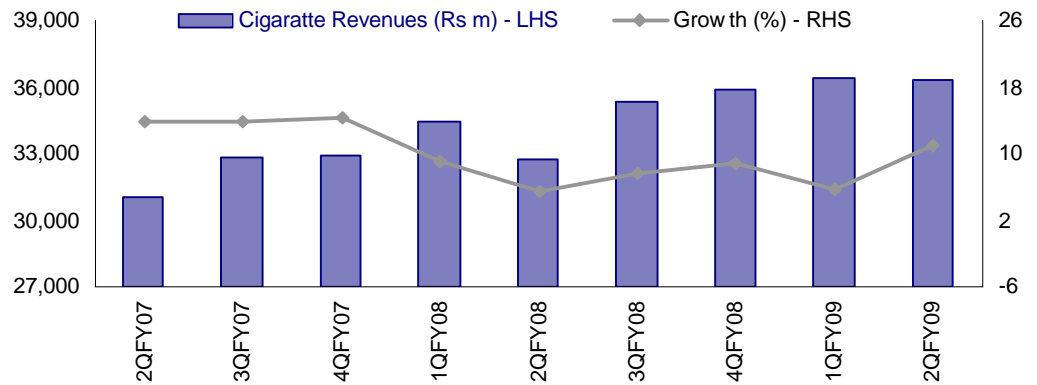
Cigarette volume declines 2%; price increase to boost margins in 2HFY09

Cigarette volumes declined 2% (2.25% in 1HFY09), following the discontinuation of sale of non-filter cigarettes (19% of volumes). The micros segment has been completely lost to the unorganized sector while the plains segment has reported 75-80% conversion to Filter cigarettes.

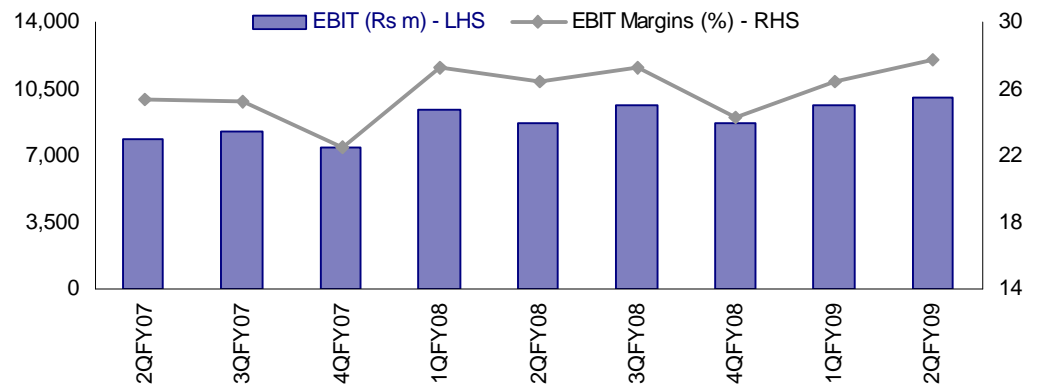
Cigarette business gross sales grew 10.9%, PBIT grew 16.6%, as margins expanded 135bp. Profit margins would have been higher by 50-60bp, but for continued investments in point-of-sale promotions. Management expects margins to improve further, as benefits of average 5-6% price increase (*Classic, Gold Flake Kings, Gold Flake and Berkeley*) would be fully reflected in the coming quarters.

Recently, the government has enforced a ban on cigarette smoking in public places. We do not expect a meaningful impact on volumes due to this directive. Our estimates factor in 4% decline in cigarette volumes in FY09.

CIGARETTES – INCREASE IN PRICES BOOST SALES GROWTH



PRICE INCREASE IMPROVE OPERATING PERFORMANCE



Source: Company/Motilal Oswal Securities

Other FMCG: improving acceptability in personal care; entry into new segments likely in 4QFY09

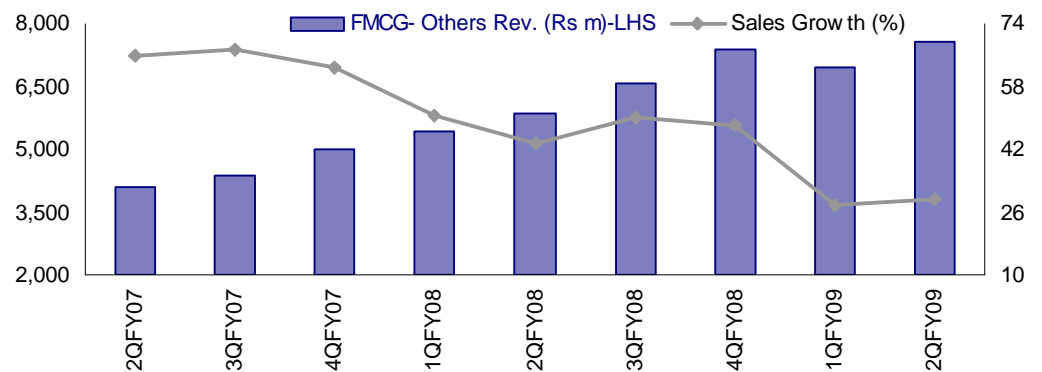
New FMCG business sales grew 29.4% to Rs7.6b while PBIT losses increased 219% to Rs1.16b (Rs1.22b in 1QFY09); PBIT margins improved 230bp QoQ but declined 913bp YoY. Management has guided new FMCG business losses of Rs4b in FY09 (Rs2.4b loss in 1HFY09).

Processed foods: Branded foods reported 24% increase in sales in a highly inflationary environment. The company maintained 11.5% market share in biscuits and 16% in potato chips. Continued rise in raw material prices has impacted profitability. The *Bingo!* product range got further enhanced with the recent launch of finger snack *Hatke Jhatke* in two flavors – funky masala and tomato twist. *Sunfeast* range of biscuits continues to post strong growth and *Aashirvaad* continues to maintain its leadership position.

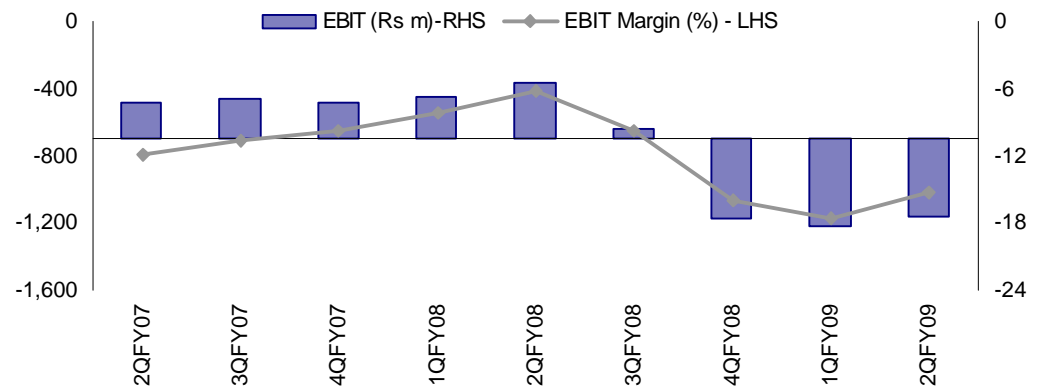
Lifestyle retailing: Lifestyle retailing continued to enhance consumer franchise, with 53 *Wills Lifestyle* stores. Margins remained under pressure due to rising lease rentals. However, the company is trying to mitigate the impact by re-negotiating the rental cost, taking early positions in key malls, and is considering selective ownership of stores.

Personal care: ITC continues to expand its presence in this category and plans to increase its offerings to gain footprint amongst the national branded players. Personal care has launched *Superia* range of anti-dandruff shampoo. All the key brands like *Fiama Di Wills*, *Vivel Di Wills*, *Vivel* and *Superia* continued to gain consumer franchise. The company has taken up extensive distribution and R&D investments to keep robust pipelines of products and variants. Planned launches include anti-dandruff shampoo variants of *Vivel* and *Fiama Di Wills*. New personal care launches are likely by 4QFY09.

OTHER FMCG – MODERATING GROWTH RATES



SEQUENTIAL IMPROVEMENT IN MARGINS

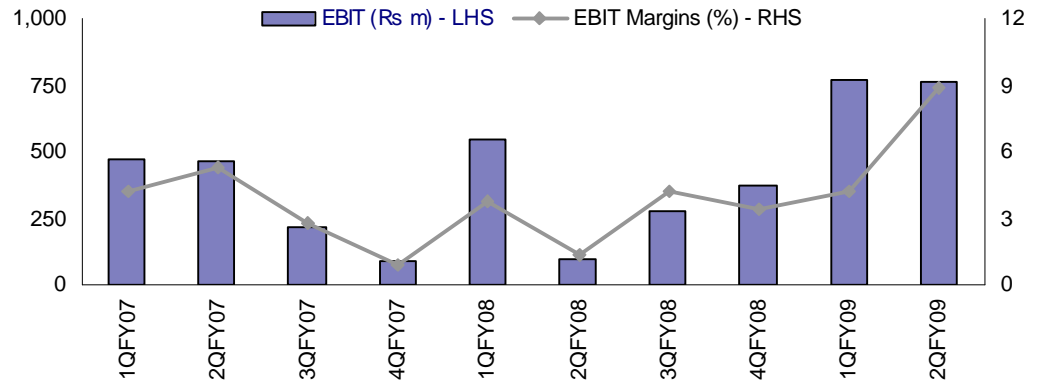


Source: Company/Motilal Oswal Securities

Agri business: spurt in leaf tobacco prices boost operating performance

Agri business reported 16.7% increase in sales and 668% increase in PBIT, as margins expanded to 8.8% (1.3% in 2QFY09). 80% spurt in the price of leaf tobacco crop from Andhra Pradesh on demand-supply mismatch boosted profitability. Leaf Tobacco export margins are near its peak. The country has harvested bumper soy crop of 10-11m tons as against normal level of 7m tons. This should boost soy export prospects in coming quarters. e-Choupal continues to improve farmer effectiveness through the establishment of IT enabled virtual network.

INCREASE IN REALIZATIONS OF LEAF TOBACCO BOOSTS MARGINS

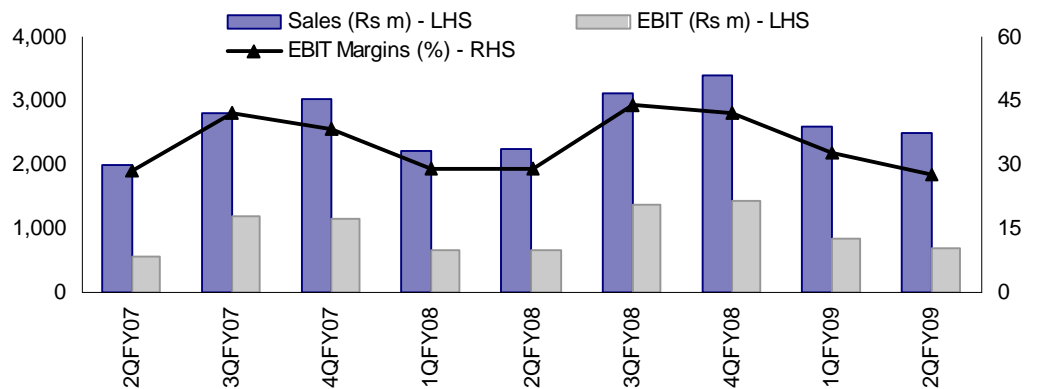


Source: Company/Motilal Oswal Securities

Hotels: occupancy and room rents to take a hit

Hotels business reported 9.7% increase in sales and 4.2% increase in PBIT, as margins declined by 158bp. The business maintained growth in ARR (average revenue per room) and occupancy levels. Segment is likely to remain under pressure in coming quarters, as the global financial meltdown would adversely impact both leisure and business travel. New properties in Bangalore and Chennai are expected to commence in FY10 and FY11, respectively.

HOTELS – OPERATING MARGINS TO REMAIN UNDER PRESSURE



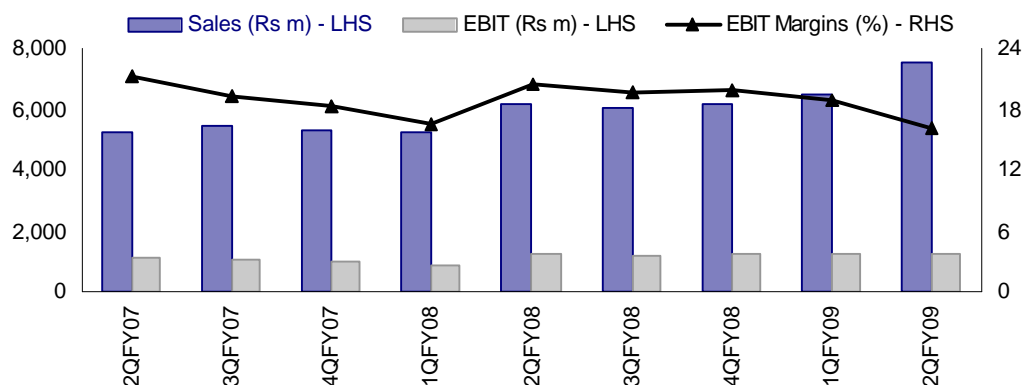
Source: Company/Motilal Oswal Securities

Paper & paperboards: input costs impact margins; bounce back likely in 2HFY09

Paper & paperboards reported 22.6% increase in sales and 2.6% decline in PBIT, as margins declined by 420bp. Increase in depreciation on new writing paper unit and sharp increase in input prices of coal, power and fuel impacted margins.

Input cost pressure was partly mitigated by increase in sales realization (increase of Rs1,000/2,000 per mt). Management has guided increase in profit margins in coming quarters as stabilization of pulp facility (122,000 ton) and decline in coal prices would enable margins to expand. Stabilization of 100,000tpa writing and printing paper facility with forward linkages to stationary business will boost prospects in the coming quarters.

PAPER & PAPERBOARDS – STEADFAST



Source: Company/Motilal Oswal Securities

Valuation and view

ITC has been facing considerable headwinds in the cigarette business in the past couple of years. 75-80% filter cigarette conversion and expansion is positive. New FMCG is expected to remain in investment mode in the medium term. Hotels business is likely to witness pressure on sales and profits while paper business should bounce back in the coming quarters. The stock trades at 17.5x FY09E EPS of Rs9 and 15.1x FY10E EPS of Rs10.5. We maintain **Buy**.

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.
- ✍ Higher than expected losses in New FMCG business will impact profitability.

Recent developments

- ✍ Launch of superia anti-dandruff shampoo.
- ✍ Launch of Hatke Jhatke variants in Bingo.

Valuation and view

- ✍ We have EPS forecasts of Rs9 for FY09 and Rs10.5 for FY10.
- ✍ The stock trades at 17.5x FY09E and 15.1x FY10E. Maintain **Buy** with SOTP-based target price of Rs220.

Sector view

- ✍ We have a cautious view on the sector on the back of inflationary tendency in the economy, which might impact volumes as well as profit margins of companies.
- ✍ Companies with low competitive pressures and broad product portfolios will be able to better withstand any slowdown in a particular segment.
- ✍ Longer-term prospects are bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		ITC	HUL	NESTLE
P/E (x)	FY09E	17.5	25.2	29.6
	FY10E	15.1	21.6	23.3
EV/EBITDA (x)	FY09E	11.2	20.3	19.3
	FY10E	9.5	18.5	15.2
EV/Sales (x)	FY09E	3.3	3.0	4.0
	FY10E	2.7	2.7	3.3
P/BV (x)	FY09E	4.3	15.3	26.0
	FY10E	3.8	22.8	20.1

SHAREHOLDING PATTERN (%)

	SEP-08	JUN-08	SEP-07
Promoter	0.0	0.0	0.0
Domestic Inst	38.2	38.2	37.7
Foreign	46.8	46.8	47.1
Others	15.1	15.0	15.2

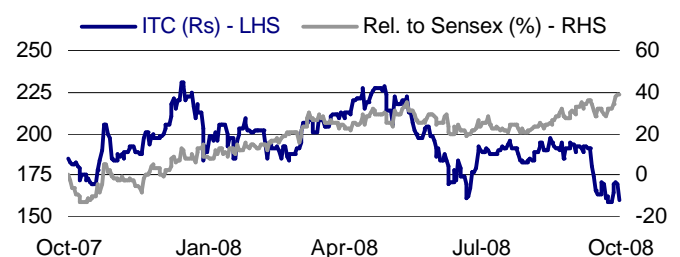
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	9.0	9.2	-2.0
FY10	10.5	10.7	-2.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
159	220	39.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Revenues	98,956	121,643	139,475	168,933	203,738	
Change (%)	27.3	22.9	14.7	21.1	20.6	
Total Expenditure	-64,578	-82,005	-95,363	-119,422	-146,539	
EBITDA	34,378	39,638	44,113	49,511	57,199	
Change (%)	17.3	15.3	11.3	12.2	15.5	
Margin (%)	34.7	32.6	31.6	29.3	28.1	
Depreciation	-3,323	-3,629	-4,385	-5,230	-5,830	
Int. and Fin. Charges	-173	-107	-120	-100	-90	
Other Income - Recurring	2,861	3,365	6,109	5,494	6,420	
Profit before Taxes	33,743	39,267	45,718	49,675	57,699	
Change (%)	20.2	16.4	16.4	8.7	16.2	
Margin (%)	34.1	32.3	32.8	29.4	28.3	
Tax	-10,584	-11,946	-13,690	-15,052	-17,483	
Deferred Tax	696	-321	-827	-745	-865	
Tax Rate (%)	-29.3	-31.2	-31.8	-31.8	-31.8	
Profit after Taxes	23,855	27,000	31,201	33,878	39,351	
Change (%)	21.0	13.2	15.6	8.6	16.2	
Margin (%)	24.1	22.2	22.4	20.1	19.3	
Non-rec. (Exp)/Income	-450	0	0	0	0	
Reported PAT	23,405	27,000	31,201	33,878	39,351	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Share Capital	3,755	3,762	3,769	3,769	3,769	
Reserves	86,860	100,609	116,808	133,613	154,517	
Net Worth	90,615	104,371	120,577	137,382	158,285	
Loans	1,197	2,009	2,144	2,009	2,009	
Deferred Liability	3,248	4,729	5,451	4,499	3,413	
Capital Employed	95,060	111,108	128,172	143,890	163,707	
Gross Block	62,272	71,343	89,597	104,597	116,597	
Less: Accum. Depn.	-20,654	-23,895	-27,909	-33,139	-38,968	
Net Fixed Assets	41,617	47,448	61,688	71,458	77,629	
Capital WIP	2,434	8,661	11,268	6,000	5,000	
Investments	35,170	30,678	29,346	37,212	43,641	
Curr. Assets, L&A	51,619	62,897	70,193	81,442	98,274	
Inventory	26,363	33,540	40,505	48,635	60,338	
Account Receivables	5,480	6,367	7,369	9,025	10,745	
Cash and Bank Balance	8,558	9,002	5,703	6,113	7,404	
Others	11,218	13,988	16,616	17,669	19,787	
Curr. Liab. and Prov.	35,781	38,576	44,323	52,222	60,837	
Account Payables	21,484	23,434	27,397	33,503	40,573	
Other Liabilities	2,674	3,478	3,735	4,126	4,496	
Provisions	11,622	11,664	13,191	14,593	15,768	
Net Current Assets	15,838	24,321	25,870	29,220	37,437	
Application of Funds	95,060	111,108	128,172	143,890	163,707	

E: MOST Estimates

RATIOS						
Y/E MARCH	2006	2007	2008	2009E	2010E	
Basic (Rs)						
EPS	6.3	7.2	8.3	9.0	10.5	
Cash EPS	7.2	8.1	9.5	10.4	12.0	
BV/Share	24.1	27.7	32.0	36.5	42.1	
DPS	2.6	3.1	3.5	3.9	4.2	
Payout %	41.8	43.2	42.3	43.1	40.1	
Valuation (x)						
P/E		22.2	19.2	17.7	15.2	
Cash P/E		19.5	16.8	15.3	13.2	
EV/Sales		4.6	4.1	3.3	2.7	
EV/EBITDA		14.1	12.8	11.2	9.6	
P/BV		5.7	5.0	4.4	3.8	
Dividend Yield (%)		1.9	2.2	2.4	2.6	
Return Ratios (%)						
RoE	26.3	25.9	25.9	24.7	24.9	
RoCE	35.7	35.4	35.8	34.6	35.3	
Working Capital Ratios						
Debtor (Days)	20	19	19	20	19	
Asset Turnover (x)	1.0	1.1	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	2006	2007	2008	2009E	2010E	
OP/(loss) before Tax	31,055	36,009	39,728	44,281	51,370	
Int./Div. Received	2,861	3,365	6,109	5,494	6,420	
Depreciation and Amort.	3,323	3,629	4,385	5,230	5,830	
Interest Paid	-173	-107	-120	-100	-90	
Direct Taxes Paid	-10,584	-11,946	-13,690	-15,052	-17,483	
(Incr)/Decr in WC	-2,782	-8,040	-4,848	-2,940	-6,926	
Deff Tax	-513	1,481	722	-951	-1,087	
CF from Operations	23,187	24,391	32,287	35,962	38,034	
(Incr)/Decr in FA	-5,382	-15,299	-20,861	-9,732	-11,000	
(Pur)/Sale of Investments	3,577	4,492	1,332	-7,866	-6,429	
CF from Invest.	-1,804	-10,805	-19,528	-17,596	-17,426	
Issue of Shares	650	424	446	0	0	
(Incr)/Decr in Debt	-1,256	812	136	-136	0	
Dividend Paid	-11,347	-13,645	-15,432	-17,073	-18,448	
Exceptional Income	-450	0	0	0	0	
Others	-979	-732	-1,208	-747	-869	
CF from Fin. Activity	-13,382	-13,142	-16,058	-17,956	-19,317	
Incr/Decr of Cash	8,001	444	-3,298	411	1,291	
Add: Opening Balance	557	8,558	9,002	5,703	6,113	
Closing Balance	8,558	9,002	5,703	6,113	7,404	

N O T E S



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	ITC
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3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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