Detailed Report
SECTOR: FMCG

ITC

Back in the reckoning

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ITC

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,989	ITC IN
	REUTERS CODE
S&P CNX: 4,075	ITC.BO

21 August 2007

Buy

Previous Recommendation: Buy

Rs152

Y/E MARCH	2006	2007	2008E	2009E
Net Sales (Rs m)	97,905	123,693	142,347	174,017
EBITDA (Rs m)	33,327	39,564	42,971	50,999
NP (Rs m)	22,353	27,000	29,374	34,809
EPS (Rs)	6.1	7.2	7.8	9.3
EPS Growth (%)	24.1	18.2	9.0	18.5
BV/Share (Rs)	24.1	27.8	31.6	36.0
P/E (x)	25.1	21.2	19.5	16.5
P/BV (x)	6.3	5.5	4.8	4.2
EV/EBITDA (x)	15.9	13.5	12.3	10.0
EV/Sales (x)	5.4	4.3	3.7	2.9
RoE (%)	25.2	25.9	24.8	25.8
RoCE (%)	34.6	35.4	34.0	35.4

Cigarette volumes to bounce back by 4QFY08: We expect volumes to start recovering 4QFY08 onward and upgrade our cigarette volume growth estimates for FY08 to -3% v/s -6% estimated earlier and for FY09 to 5% (v/s 4%). ITC increased cigarette prices by 20% as excise was increased by 5% and VAT of 12.5% was imposed. This led to a 2% decline in cigarette volumes in 1QFY08. However, the cigarette volume decline has been lower versus our expectation.

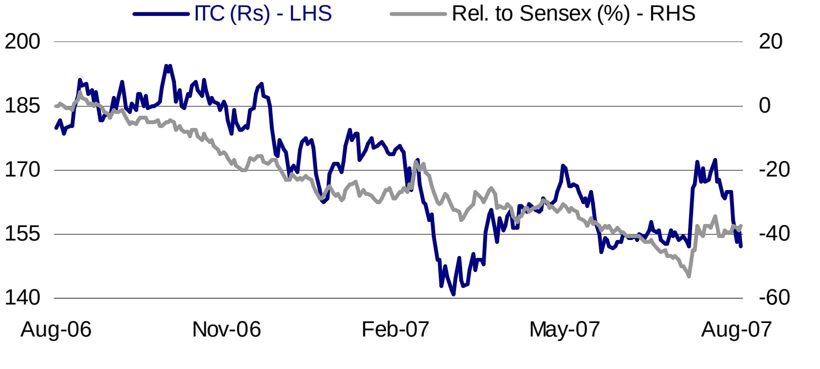
Growth in Paper & Branded Foods to accelerate: We expect the paperboard and packaging business to improve topline and margins due to increasing paper capacity by 50% in FY09. Branded Foods business will likely record higher growth rates owing to success of Bingo (potato wafers), continued growth momentum in Sunfeast (biscuits) and Aashirwad (*atta*). We expect Branded Food sales to achieve up to Rs25b by end-FY09 from current levels of Rs11b.

Upgrading estimates, valuations attractive; maintain Buy: The buoyant macro outlook for ITC prompts us to revise our EPS estimates for FY08 to Rs7.8 (Rs7.5 earlier) and for FY09 to Rs9.3 (Rs9). We expect the company to record 20% CAGR in profits post-FY08. Given strong free cash flows, popular brands, market leadership in key businesses and the potential offered by ITC's e-Choupal initiative, we believe the stock is attractive. We maintain **Buy**, with an SOTP-based target price of Rs203 - a 33% upside.

KEY FINANCIALS	
Shares Outstanding (m)	3,762.2
Market Cap. (Rs b)	572.6
Market Cap. (US$ b)	14.0
Past 3 yrs. Sales Growth (%)	17.9
Past 3 yrs. NP Growth (%)	29.4
Dividend Payout (%)	31.1
Dividend Yield (%)	2.0

STOCK DATA	
52-Week Range	196/140
Major Shareholders (as of June 2007)	%
Promoters	0.0
Domestic Institutions	37.6
FIIs/FDIs	46.9
Others	15.5
Average Daily Turnover	
Volume ('000 shares)	6,329.2
Value (Rs million)	1,060.9
1/6/12 Month Rel. Performance (%)	9/-11/-37
1/6/12 Month Abs. Performance (%)	-1/-13/-16

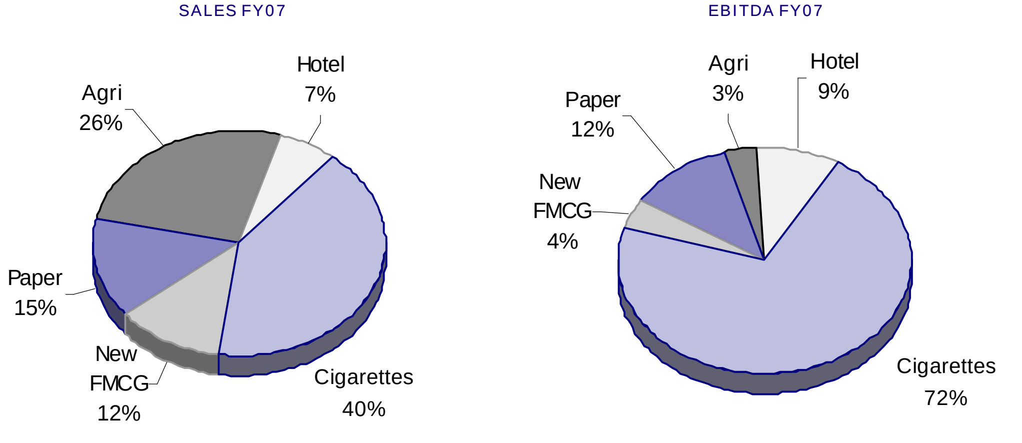
STOCK PERFORMANCE (1 YEAR)



Cigarette volumes to bounce back by 4QFY08

We are upgrading our cigarette volume growth estimates for FY08 to -3% versus -6% estimated earlier and for FY09 to 5% (v/s 4%). We believe this upgradation is significant for ITC's overall profit growth, as cigarettes continue to contribute 75% to the EBITDA of the company.

SEGMENT-WISE CONTRIBUTION



Source: Company/Motilal Oswal Securities

VAT levy has a lower impact on cigarette volumes v/s our estimate

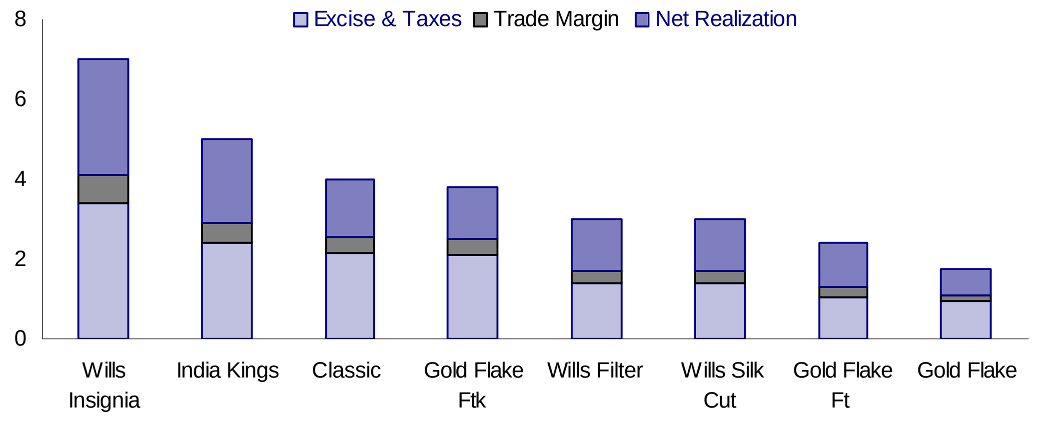
Post a 5% increase in excise levy, 12.5% VAT and 33% trade tax (in Uttar Pradesh), on cigarettes, cigarette demand across industry has shown resilience in the scenario of a buoyant economy and consumer upgradation. We estimated the impact of these levies to be 14% on end-consumer prices. As a consequence, during the current year, we were expecting industry sales to shrink significantly.

UNIT PRICE INCREASES FOR ITC'S CIGARETTES POST 20% VAT LEVY

CIGARETTES	OLD RS PER PACK	NEW RS PER PACK	CHANGE RS PER PACK	CHG. (%)
Wills Insignia	120.0	140.0	20.0	16.7
India Kings 20ss	90.0	100.0	10.0	11.1
B&H Spl. & B&H lights	80.0	90.0	10.0	12.5
Classic 20ss	70.0	80.0	10.0	14.3
Gold Flake FTK 20ss & 10ss	34.0	38.0	4.0	11.8
Wills Silk Cut 20ss & 10ss	27.0	30.0	3.0	11.1
Gold Flake ft 20ss & 10ss	20.0	24.0	4.0	20.0
Gold Flake 10ss	14.8	17.5	2.8	18.6
Scissors 10ss	12.0	15.0	3.0	25.0

Source: Industry/Motilal Oswal Securities

POST VAT TAXATION ON CIGARETTES



Source: Motilal Oswal Securities

Although the impact was visible only in the months of May and June, the first quarter surprised us with modest industry volume growth of 2%. We however, had expected a steeper cigarette volume decline of 6% per annum for ITC, which had increased prices by 20% in response to the increased levies mentioned above. On the other hand, ITC has merely reported a cigarette volume decline of 2% for 1QFY08, which is better versus our estimate.

We believe cigarette demand recovery could be earlier v/s our expectation

The resilience shown by the consumer has been notable, particularly as the decline in cigarette demand in the initial period post the sharp price increase is usually steeper. We also note that the during this period, industry witnessed growth of lesser-known brands that fitted in with various consumer price points, in response to the increased unit prices of cigarettes. All this prompts us to believe that in a vibrant economy, demand recovery could be earlier than we had anticipated. We thereby upgrade our cigarette volume growth estimates for FY08 to -3% versus -6% estimated earlier and for FY09 to 5% (v/s 4%). As the price increase of 20% is significantly higher v/s the impact of various levies and taxes, we expect EBITDA margins to expand from 55.5% in FY07 to 60.5% in FY08 and 61.5% in FY09. This should increase cigarette business EBITDA by 6.8% in FY08 to 14.8% in FY09.

According to our base case scenario, we have assumed cigarette volume growth of -3% over FY08E, which translates to corresponding EPS estimates of Rs7.80 and Rs9.30 for the respective years. In our optimistic case, our volume growth estimates are flat for FY08E. Our pessimistic volume growth estimates for FY08 are -6%.

Our estimates factor in a 5% excise levy increase each year in FY08 and FY09 while assuming VAT at 12.5%. We also believe that ITC is well positioned to pass on 5% (2.8% price increase) excise increase to the consumer with no significant impact on demand.

We believe the worst is over for ITC in terms of the VAT overhang and its impact on cigarette demand and profits. We hence expect better times ahead for the company.

New FMCG - turnaround likely by 2010

ITC's fastest growing segment contributes 9% to topline

New FMCG comprises ITC's fastest growing businesses, which includes Processed Foods, Lifestyle Retailing, Greetings, Stationery, Matchboxes and contributes 9% to the topline.

Food products contribute 62% to new FMCG products with brands such as Sunfeast, Kitchens of India, Aashirvaad and Mint-o. ITC has emerged as the third largest player in the Rs45b biscuit industry and is a market leader in branded atta (52% share of the organized market). The company markets more than 100 SKUs and plans to enter new product segments. It is currently growing by more than 40% per annum in the Biscuit category and expects to maintain the trend. ITC has forayed into Rs20b (30% CAGR growth) snack food segment with the launch of Bingo range of potato chips and finger snack foods. The product has been launched in 160 flavors and is expected to scale up at a fast pace.

Lifestyle retailing under the Wills Lifestyle and John Players brands has entered the fast growth lane. With expected growth of 20% in the domestic branded garments industry, this division is likely to grow by 25-30% ahead.

We expect school books and stationery to be the next trigger for growth

We expect school books and the stationery business to emerge as the next growth driver, once the company commissions its own writing paper unit. The division, which is expected to clock sales of over Rs1b in FY07, has established brands like Classmate and Paper Craft. The division has gross margins of 20% and holds immense scale-up potential once in-house paper availability increases. We estimate 46% CAGR in sales over FY07-FY09 and 32% CAGR reduction in losses over next two years. We expect the new FMCG businesses to turnaround in FY10 with an EBITDA of Rs980m.

Paperboard & specialty packaging - set to enter the fast lane

ITC is currently a leader in Paperboard and Specialty Packaging

The company has emerged a leader in Paperboard and Specialty Packaging, with growing focus on high-value packaging solutions for consumer goods and pharmaceuticals. The company is in the process of increasing paperboard capacity by 90,000 tonnes. Additionally, plans are underway to set up a writing & printing paper unit and an ECF (elemental chlorine-free) pulp capacity, each of 100,000t p.a., at Bhadrachalam. The ECF pulp capacity will enable the company to overcome its dependence on imported pulp thereby improving profitability. ITC appears well placed, as the area under its forestation scheme will increase to 100,000 hectares by FY10.

ITC's paperboard business has been recording steady 19% EBITDA CAGR over the past five years. With long-term outlook for the paper division being positive, we expect the share of high-end paperboard and consumer stationery products to rein in enhanced profits. Also, the new unit will enable increased sale of value-added products.

e- Choupal format - leveraging rural potential

e-Choupal is ITC's green initiative

ITC has introduced an innovative and successful e-Choupal model that has created a two-way sourcing-cum-distribution system in rural India. It is currently ramping up this format - the number of e-Choupals has increased to 6,400, with reach to over 3.5m farmers in nearly 38,500 villages. ITC aims to: (1) set up 20,000 e-Choupals in the next 7-10 years serving over 100,000 villages (one-sixths of rural India); (2) reach 15 states, up from nine currently.

Rural India, we believe, is on the crest of a strong upwave, particularly as the government's recent initiatives for upgrading rural infrastructure is gaining support from growing corporate interest. The benefits of these rural initiatives will start accruing from FY09. The Government of India has initiated stepping up irrigation spend to ~Rs400b over a 5-year term and simultaneously doubling milk production via the National Horticulture Mission, to over 350 tonnes by 2011. ITC has created a strong head start and 'backend' for the government's rural initiative, which would enable it to earn rewards from the expected surge in rural economy.

Choupal Sagar is positioned as a one-stop-shop to warehouse agri-produce

Choupal Sagar - giving rural India a taste of organized retailing: Choupal Sagar - a rural hypermart, is an extension of ITC's rural distribution strategy. It is already operating 21 Choupal Sagars across three states - Uttar Pradesh, Madhya Pradesh and Maharashtra. The setting up of eight more Choupal Sagars is already in an advanced stage, with operations expected to commence in the next 1-2 quarters. The company plans to increase this number to 40 in the next 12 months and 100 in the next three years.

ITC has positioned Choupal Sagar as a one-stop shop for warehousing of agri-produce, a fuel station, healthcare, soil testing, banking, food court and tractor servicing. The Sagars will also sell agri-inputs, apparel, grocery, durables, toys, music etc. with Uttam Quality, Sahi Jaankari, and Kam Daam. The company has tied up with a client, Merubeni - Merubeni and ITC will work together to explore new products and opportunities - whereby ITC will gain from Merubeni's expertise in setting up strong supply chain processes and warehouses ('backend'). We expect ITC to commission up to 40 Choupal Sagars by FY09, which should yield annual sales of Rs2b.

Choupal Fresh stores market fruits and vegetables in towns and cities

Choupal Fresh - end-to-end solution: The launch of Choupal Fresh stores signals a further extension of ITC's rural integration strategy. ITC has opened three pilot stores to market fresh fruits and vegetables in Pune, Hyderabad and Chandigarh. In this project, ITC's partners are three consortium players - Snowman (for logistics), Mitsubishi (cold chain) and US Aid Agency (crop calendaring and best agricultural practices). These stores operate as cash-and-carry stores during the early morning for retail traders, and later in the day, they are open for retail consumers. Each store is spread over 2,500sq. ft. in the front end with a warehouse at the back end, spread over 7,500 sq. ft. We believe the potential in this area of activity is likely huge assuming a population of 200m in the top 20 cities in India - the target market being 30% and the average spend on fruit and vegetables at Rs100 per week per person - we arrive at a market value of Rs312b.

Hotels - limited headroom

Hotels business offers little scope for margin expansion

Earnings of ITC's hotel business currently reflect the gains from higher occupancy rates and average room rates (ARRs) prevailing in the hotel industry. For FY07, the division has reported 25.8% increase in topline and 27.7% increase in EBITDA. ITC plans to add 1,100-1,200 rooms in three new properties at Bangalore, Chennai and Hyderabad. Construction of the Bangalore property is underway while the company is yet to begin construction at its Chennai property. While we have positive expectations with regard to ARRs in the Hyderabad property, we believe ARRs in Bangalore are expected to soften post-FY2008 owing to the new properties going on stream. We expect the growth rate to slow down due to limited headroom for increasing occupancy. We expect ARR to increase by 15%-20% in the next two years but margins to decline, as the new properties begin operations in FY09. Having taken into account rupee appreciation, we expect hotels to report 16.7% CAGR in sales and 12.5% CAGR in EBITDA over FY07-FY09.

20% PAT CAGR likely post FY08

We expect profit growth of 17% over FY07-FY09

We expect ITC to post steady growth in the coming few years. We estimate sales and PAT growth at 19.7% and 17.2% over FY07-FY10. The sales and PAT growth post FY08 is expected to be above 20% as the impact of VAT imposition on cigarettes will be likely over by 2008. We expect sharp growth in paper business post FY08 and expect new FMCG businesses to turnaround by 2010.

Valuations attractive; Buy

We recommend Buy. Our SOTP target price builds in 33% upside

The stock has underperformed the BSE Sensex in the past one year by 39% owing to uncertainty of cigarette volumes over VAT imposition. Given the company's strong free cash flows, popular brands, market leadership in key businesses and the immense potential offered by its e-Choupal initiative, we remain positive on the stock. We maintain **Buy**, with an SOTP-based target price of Rs203, a 33% upside.

SOTP VALUATION HAS TARGET PRICE OF RS203

	GROSS SALES	EBITDA	BASIS	MULTIPLE	VALUE	RATIONALE
Cigarettes	165,599	40,192	EV/EBITDA	14.0	562,687	
New FMCG	36,720	-826	2x Sales	2.0	73,440	30% discount to peers
Hotels	13,056	5,484	EV/EBITDA	6.5	35,643	10% discount to market leader
Paper	15,210	6,727	EV/EBITDA	4.0	26,910	In line with market leader Bilt
Agri	46,423	2,298	EV/EBITDA	3.5	8,044	
Choupal Sagar	2,003		1.5x Sales	1.0	2,003	
Investments					54,158	
Total					**762,884**	
Value per Share (Rs)					203	
Current Market Price (Rs)					152	
Upside (%)					33	

Source: Motilal Oswal Securities

Cigarettes: Volume growth shows resilience

The growing cigarette consumption reflects strong economic growth, resultant higher GDP and consumers' higher purchasing power. We expect cigarette demand in India to continue to grow steadily unlike several developed markets, wherein cigarette sales are declining.

The trend of rising filter cigarette volumes will continue

The industry has witnessed cigarette sales decline by 2% in volume terms in 1QFY08 owing to an across-the-board 5% excise hike and 12.5% VAT implementation. We expect volumes to decline by 3% in FY08 and record an increase of 5% during FY09. The share of filter cigarettes to total sales volume has been rising over the past few years and we expect this trend to continue, given the current wave of consumer upgradation.

Cigarette demand — resilient to VAT imposition

The removal of cigarettes from the category of 'declared goods' resulted in imposition of 12.5% VAT in April 2007. In addition, the state of Uttar Pradesh imposed 33.5% trade tax on cigarettes.

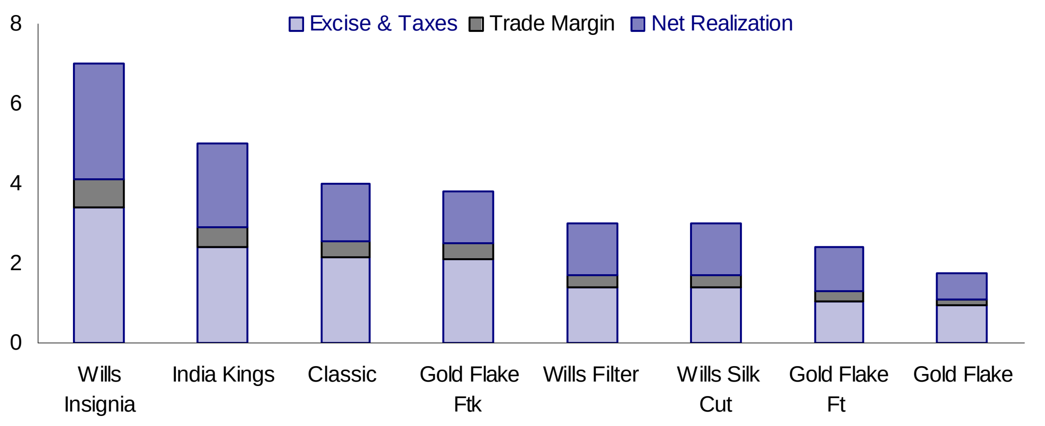
ITC increased cigarette prices on an average by 20% across its cigarette product portfolio in order to pass on the impact of VAT imposition and the 5% increase in excise levy. We had factored in 6% volume decline in cigarettes for the full year. ITC has reported 2% decline in volumes for 1QFY08 better than our estimates. The resilience shown by the consumer has been notable, particularly as the decline in cigarette demand in the initial period post the sharp price increase is usually steeper.

UNIT PRICE INCREASES FOR ITC'S CIGARETTES POST 20% VAT LEVY

CIGARETTES	OLD RS PER PACK	NEW RS PER PACK	CHANGE RS PER PACK	CHG. (%)
Wills Insignia	120.0	140.0	20.0	16.7
India Kings 20ss	90.0	100.0	10.0	11.1
India Kings lights 20ss	90.0	100.0	10.0	11.1
555 FTK & 555 lights FTK	80.0	90.0	10.0	12.5
B&H Spl. & B&H lights	80.0	90.0	10.0	12.5
Classic 20ss & 10ss	70.0	80.0	10.0	14.3
Classic Mild 20ss & 10ss	70.0	80.0	10.0	14.3
Classic Menthol 20ss	70.0	80.0	10.0	14.3
Classic ult 20ss & 10ss	70.0	80.0	10.0	14.3
Gold Flake FTK 20ss & 10 ss	34.0	38.0	4.0	11.8
Gold flake FTK lights 20ss & 10ss	34.0	38.0	4.0	11.8
Wills Filter 20ss & 10ss	27.0	30.0	3.0	11.1
Wills Silk Cut 20ss & 10ss	27.0	30.0	3.0	11.1
Gold Flake ft 20ss & 10ss	20.0	24.0	4.0	20.0
Gold Flake 10ss	14.8	17.5	2.8	18.6
Scissors 10ss	12.0	15.0	3.0	25.0
Scissors Standard 10ss	4.5	5.0	0.5	11.1

Source: Industry/Motilal Oswal Securities

POST VAT TAXATION ON CIGARETTES



Source: Motilal Oswal Securities

SENSITIVITY OF CIGARETTE DIVISION PROFITS TO VOLUMES

	VOLUME GROWTH (%)		CIGARETTES EBIDTA (RS M)		EPS (RS)	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Optimistic	0.0	5.0	35,971	41,309	8.0	9.5
Base Case	-3.0	5.0	35,020	40,192	7.8	9.3
Pessimistic	-6.0	5.0	33,750	38,331	7.6	9.0

Source: Motilal Oswal Securities

Under the various scenarios for cigarette volume growth, we believe FY0E8 EPS would range from Rs7.56 (pessimistic) to Rs8 (optimistic). Likewise for FY09E EPS.

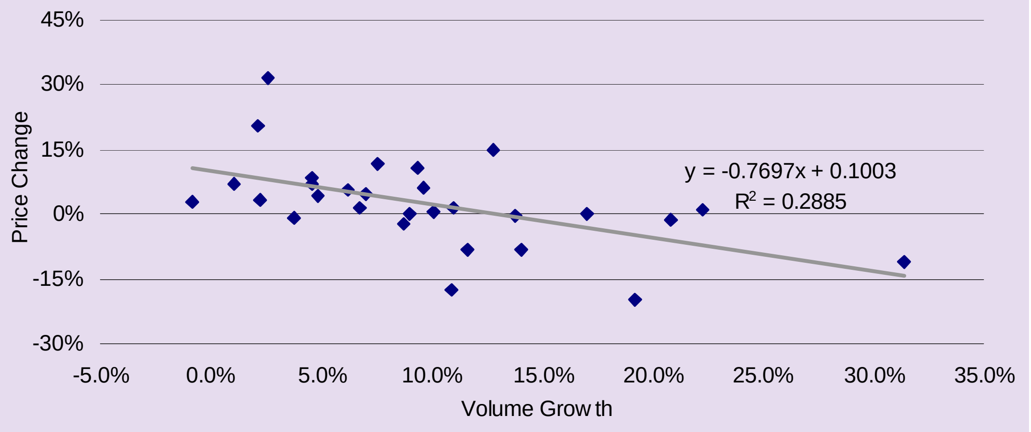
We expect cigarette growth rates to start improving in 4QFY08

We expect cigarette volumes to decline by 4% over the next two quarters before they start moving up in 4QFY08. We are increasing our volume growth estimates for FY08 to -3% versus our earlier estimate of -6% and for FY09 to 5% from 4%. We expect some consumer downtrading in the bottom end of the market but the filter segment is expected to remain steady. We estimate 5% increase in excise duty over the next two years as well. We have assumed flat rate of VAT in our estimates assuming that Uttar Pradesh will also follow the uniform VAT rate, once VAT replaces the local trade tax.

ITC has reported 15% increase in PBIT on 8.9% increase in sales for 1QFY08 translating to 150bp margin expansion. We expect cigarette business to report 6.8% and 14.8% increase in EBITDA on the back of 120bp and 60bp margin expansion in FY08 and FY09.

In support of our estimates, we ran a linear regression curve with change in cigarette price as an independent variable (X) and change in sales volume as a dependent variable (Y). For ITC we used price and volume data since 1975 and derived the following best fit from the trend in cigarette prices and volumes.

REGRESSION OF CIGARETTE VOLUME GROWTH AND PRICE CHANGE



Source: Company/Motilal Oswal Securities

The regression chart explained:

According to least square method of regression: Y= a+bx

Here 'a' is the intercept and 'b' is the slope of the regression line.

A= .1003 and b= -0.7697

Therefore Y= 0.1003-0.7697X

R2=0 .2885 which means that the change in prices is not that relevant.

Our conclusion:

The lower coefficient of determination and economic buoyancy are the factors that suggest that decline in cigarette volumes would be lower versus the 6% we had assumed earlier. Consumer demand is showing resilience, as cigarette demand (industrywise) has increased by 2% in the first quarter of FY08.

The following table shows the sensitivity of volumes to a change in cigarette prices:

SENSITIVITY OF CIGARETTE PRICES AND VOLUMES (%)

PRICE CHANGE (INCREASE)	VOLUME CHANGE
5	6.6
8	3.9
10	2.3
12	0.8
14	-0.7
16	-2.3
18	-3.8
20	-5.4

Source: Motilal Oswal Securities

CIGARETTES DIVISION PERFORMANCE (RS M)

	FY04	FY05	FY06	FY07	FY08E	FY09E
Volume Growth (%)	3.1	7.1	8.3	7.2	-3.0	5.0
Excise Duty Increase (%)	0.0	0.0	10.0	5.0	5.0	5.0
Net Sales	**39,664**	**44,608**	**51,047**	**59,134**	**57,884**	**65,353**
Sales Growth (%)	7.5	12.5	14.4	15.8	-2.1	12.9
EBIDTA	**21,349**	**24,041**	**28,157**	**32,796**	**35,020**	**40,192**
EBITDA Growth (%)	5.5	12.6	17.1	16.5	6.8	14.8
EBITDA Margins (%)	53.8	53.9	55.2	55.5	60.5	61.5
Sales proportion - (%)	53.7	50.8	45.3	41.7	35.4	32.8
EBIDTA proportion (%)	87.2	82.4	78.7	77.7	76.7	74.5

Source: Motilal Oswal Securities

Notwithstanding the trend of improving cigarette volumes in the Indian market under various scenarios, we note several macro reasons that are supportive.

Strong undercurrent for growth continues

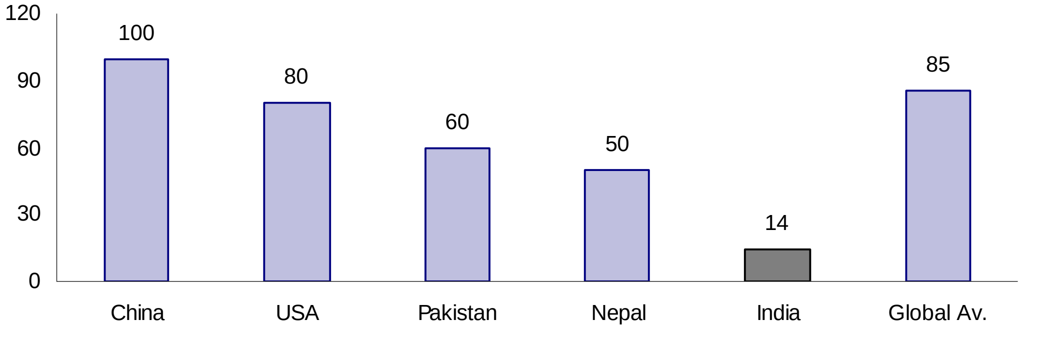
We believe there is a strong undercurrent for cigarette volume growth

We are positive on cigarette volume growth in the medium term. Our belief is based on the following triggers:

- 50% of the population is below 25 years of age, an age when youthful members give smoking a try, 65% is below the age group of 35, which translates to a segment of younger consumers with rising disposable incomes, greater exposure to foreign media (hence modern outlook) and lower aversion to smoking.
- Three consecutive years of over 9% GDP growth; strong farm income growth (buoyant production and strong commodity prices), boosting rural consumers' purchasing power
- Unit contribution per cigarette net of excise and trade margins, is much higher for the premium segment versus the popular segment
- We expect product mix to trend in favor of filter and premium categories, which will likely boost sales growth and profit margins.
- India's per capita cigarette consumption at 141 sticks is far lower v/s other developing countries in the region. But the periodic cigarette price increases have resulted in purchase of lower-priced tobacco versions. Cigarettes constitute merely 14% of total tobacco consumed in India but tobacco consumption has been growing steadily.

CIGARETTES CONSTITUTE A VERY LOW PROPORTION OF TOTAL TOBACCO CONSUMPTION IN INDIA… (%)

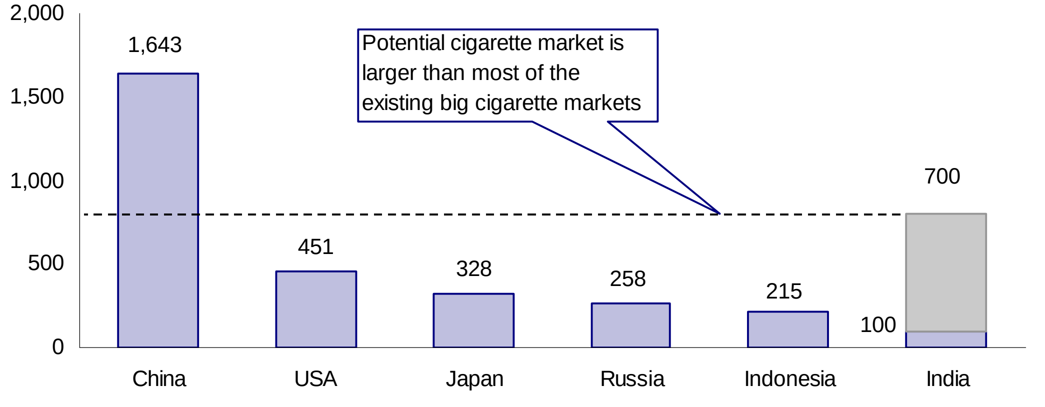
Several macro industry characteristics also support cigarette volume growth trend



Source: Tobacco Institute of India

- A buoyant economy and rising purchasing power is resulting in consumers upgrading to cigarettes.Our industry and trade interaction concludes that bidi smokers have increasingly started smoking cigarettes on special occasions.This indidcates a gradual shift in demand toward cigarettes, and particularly in favor of filter cigarettes.

INDIA'S 'BIDI' MARKET REPRESENTS A HUGE POTENTIAL CIGARETTE MARKET (BILLION STICKS)



Source: World Health Organization

New FMCG business - turnaround likely by 2010

ITC has gained a toehold in the new consumer goods categories such as branded foods, lifestyle retailing, greeting cards & gifts and matchboxes and incense sticks. The New FMCG division has been growing rapidly with annual sales expected to cross the Rs25b mark during FY08. ITC has been able to gain significant presence in processed foods, lifestyle retailing and greeting cards but the division continues to incur losses owing to heavy spend on advertising and sales promotion. We expect this strategic unit to be EBIDTA positive by FY2010.

NEW FMCG BUSINESS PERFORMANCE (RS M)

	FY04	FY05	FY06	FY07	FY08E	FY09E	FY10E
Sales	**3,144**	**5,903**	**10,135**	**17,101**	**25,977**	**36,720**	**49,394**
Growth rate (%)	*185*	*88*	*72*	*69*	*52*	*41*	*22*
EBIDTA Margins (%)	*-53.9*	*-31.9*	*-15.6*	*-10.7*	*-6.0*	*-2.3*	*2.0*
EBIDTA	**-1,694**	**-1,882**	**-1,582**	**-1,821**	**-1,559**	**-826**	**988**
EBIDTA Growth (%)	*-42.5*	*-11.1*	*15.9*	*-15.2*	*14.4*	*47.0*	
Sales Proportion (%)	*4.3*	*6.7*	*9.0*	*12.1*	*15.9*	*18.4*	*23.4*

Source: Company/ Motilal Oswal Securities

BRANDED FOODS - COMPETITOR ANALYSIS

	CONFECTIONARY	BISCUITS (SUNFEAST)	READY TO EAT	CONSUMER STAPLES	SNACK FOODS
Product & Brands	Candyman, Mint-o	Orange Marie, Butterscotch, Chocolate, Pineapple, Strawberry Cream, Glucose, Black Magic, Golden Bake, Snacky	Kitchens of India Aashirvaad Ready Meals Sunfeast Pasta, Cooking Mixes	Aashirvaad Atta, Salt, Spices	Bingo in 16 flavors
Competitors	Parry's, Nutrine, Nestle, Prefetti	Britannia, Parle, Priya Gold	MTR, Tasty Bite, Satnam Overseas, Nestle	HLL, Pillsbury, Cargill	Frito Lays, Haldirams
Mkt Size (Rs b)	25	50	2.2	NA	25
Mkt Share (Org.)	8	10	15	52	NA
Industry Structure	Fragmented with large Small scale	Large players and SSI also	A few players in small but huge potential market	Small organized market, Atta Chakki's rule the market	Fritolays has 75% market share Stiff, but more like a monopoly
Competitive scenario	Cut throat Price conscious market	Rising price based competition from regional players	Nascent but highly competitive market	Stiff competition from unorganized sector	
ITC's strength	Marketing network, brands, innovation	Raw material sourcing, product innovation and differentiation	Welcome Group Cuisine experience & Brand image	Raw Material Sourcing & marketing network	Strong raw material sourcing, innovative flavors
ITC's positioning	Mint-o and Candy-man doing well, entry into éclairs & new flavors	Reinventing the industry with new and exciting flavors, huge success	Developing category. New products, premium positioning	Market leader in branded Atta, entered into spices recently	Mass Market, Differentiated product
Future Potential	High growth potential	Exciting growth ahead	Huge growth potential, albeit in the long term	Low growth, potential only in long term	High growth potential

Source: Motilal Oswal Securities

Branded foods - gaining strength

ITC's has been the most innovative branded processed foods company in the past five years. ITC has successfully created brands like Sunfeast, Aashirvaad, Candyman, Mint-o and Kitchens of India. It today has more than 100 SKUs in food products with a local flavor in all the offerings.

ITC has been successful with processed foods

ITC has launched products in the confectionery, biscuits, ready-to-eat foods and consumer staples segments. The exhibit on page 20 (Branded Foods - Competitor Analysis) represents its competitive positioning in the branded foods business. ITC's success in processed foods stems from:

- Distribution and marketing strengths
- Cuisine expertise and strong brands from the Welcome Group stable
- Raw material sourcing advantage in staples and biscuits
- Financial wherewithal to sustain initial losses and long gestation periods

Biscuits - 3rd-largest organized player

ITC's Sunfeast brand has been growing at more than 40% in comparison with the market growth rate of 14% owing to innovative products, aggressive marketing and sales promotions. Biscuit margins are under severe pressure due to the sharp rise in raw material costs like sugar, wheat, milk etc., which the manufacturers cannot pass on, particularly in the glucose segment, which accounts for nearly 50-55% of the total market by volume. ITC is in the process of setting up a 3,000 tonne per month facility at Haridwar, Uttaranchal and Bangalore, Karnataka. In addition, the company is setting up one tied-up unit near Nagpur. ITC plans to launch Coconut Cookies, Milk Bikis etc. to complete the range ahead.

ITC expects the new units to facilitate improved servicing in their respective territories, thus enabling quick ramp up in market share and reduce overheads due to lower freight costs resulting from plants in various geographical locations. The last Union Budget has withdrawn excise duty on biscuits priced up to Rs100 per kg. This move has provided some respite to the industry, which has been reeling under sharp increase in the prices of key raw materials like wheat flour. The biscuits industry has also undertaken 8-11% price increase by reduction in pack sizes. We expect these moves to result in lower losses from the biscuits business in the current year.

Consumer staples and RTF - consolidating leadership

ITC has 52% share in the consumer staple category

ITC has grabbed more than 52% share in the US$10b category, which is currently dominated by unorganized players. It markets various consumer staples like atta (wheat flour), salt and spices under the Aashirvaad brand. It has established a clear lead over its competitors with Pillsbury, Annapoorna, and Nature Fresh brands, in a slowly evolving retail market. It has plans to add more products in this category, wherein the small and unorganized players are dominant.

ITC holds more than 35% share in the Rs1b RTF (ready-to-eat food) market, with the Kitchens of India brand. The product range includes select delicacies from the Welcome Group, mass market daily food dishes, Chutneys and Instant Mixes. The market for RTF and mixes is currently worth Rs0.8b and Rs1.5b respectively with growth rates of more than 20%. We note that the long term outlook is encouraging keeping in view the rising number of working couples, working singles and nuclear families. Export prospects of the Kitchens of India brand are encouraging, as Indians are much sought after by NRIs. ITC expects export sales to exceed domestic sales in the coming years. Exports will likely be margin accretive owing to their higher realizations.

Bingo - successful entry into fast-growth snack food

The company has entered snack foods with Bingo

ITC has entered Rs25b snack food market with Bingo brand. The company has launched potato chips and wafers in 16 flavors. The segment is dominated by Lays from Pepsi. In addition domestic players like Haldiram have a presence in this segment. The snack food category has been growing at more than 25% annually and offers huge growth potential. ITC appears to be well placed as competition in the category is very limited. Moreover ITC plans to enter into direct material sourcing agreements with farmers using its e-Choupal network, which would bring in economies in sourcing. The company plans to ramp up the sales at a fast pace as consumer response has been ahead of expectations.

Lifestyle retailing -striking the right balance

ITC has Wills and John Players brands under its lifestyle format. The company operates over 40 Wills Lifestyle and 165 John Players stores. In addition, John Players brand is also available at over 1,500 multi-brand outlets. The company markets the Essenza Di Wills brand of Personal Care products through its Wills Lifestyle stores. ITC has also been increasing presence via 'shop in shops' in various departmental stores. ITC has ambitious plans to increase the number of Wills Lifestyle stores to 100 in the next two years.

GARMENTS – COMPETITOR ANALYSIS

CATEGORY	ITC'S BRAND	COMPETITORS	MARKET LEADER
Super Premium	-	Arrow, Marks & Spencer	Arrow
Premium Formal Wear	Wills Classic	Zodiac, Louis Philipe, Arrow, Park Avenue	Park Avenue
Formal Wear (mass market)	John Players	Peter England, Excalibur, John Players, Indigo Nation	Peter England
Premium Casual Wear	Wills Club life	Allen Solly, Arrow,, ColorPlus	ColorPlus
Casual Wear	-	Parx, Sanfrisco, Oxemberg	Parx
Women wear	Wills Classic	Allen Solly, Westside	Allen Solly

Source: Motilal Oswal Securities

The readymade garments market in India is worth Rs90b and has the potential to grow at 2-3x GDP growth rate. With acceleration in the GDP growth rate from 5-6% to 8-9%, we expect readymade garment industry to grow by 20% p.a. of which ITC is tipped to be one of the biggest beneficiaries.

Stationery & Greeting Cards - big potential

We expect Stationery and Greeting Cards to be the next profit driver

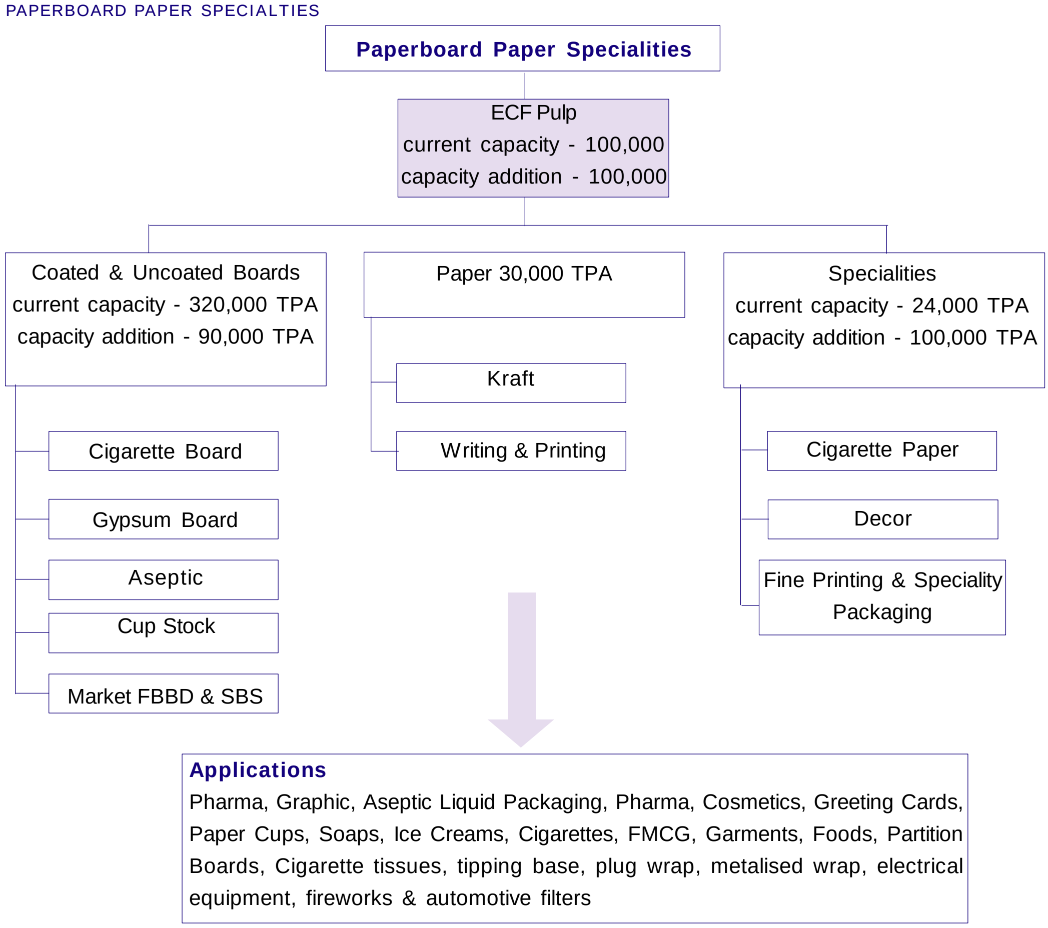
ITC has a presence in Stationery and Greeting Cards with brands like Classmate, Paper Craft and Expressions. Expressions has emerged as the largest greeting card brand sold via multi-brand outlets. ITC has been able to carve a niche for its stationery business with more than 200 varieties of notebooks, with graphic visuals on both the hard and soft covers. Its Classmate brand has already emerged as the single largest selling notebook brand in India. We believe that the notebook division has bright potential ahead, as the increasing focus on education will lead to increased demand for stationery and notebooks. We expect the stationery business to be a significant sales and profit driver for the company once the proposed 100,000 tonnes writing & printing paper unit goes on stream in 2008.

Paperboard & Specialty Packaging: Set to enter fast lane

ITC is the leader in the Paperboard segment

ITC is the domestic leader in the paperboard market, which is growing at an annual rate of 7-8%. ITC has gradually moved toward production of specialty paperboard, which incorporates higher value addition and growth potential. ITC is currently implementing capacity expansion in the following: paperboard by 90,000 tonne; each of Elemental Cholorine Free (ECF) pulp and writing & printing paper by 100,000 tonnes. The paperboard business contributes 10.7% to the sales and 13% to ITC's EBITDA.

PAPERBOARD PAPER SPECIALTIES



Source: Company/Motilal Oswal Securities

New initiatives to accelerate growth

Several initiatives in favor of capacity expansion are being adopted

ITC is currently undertaking a slew of initiatives to expand capacity, backwardly integrate and enter into new segments. All of this, is expected to increase the revenue growth rates and increase profitability.

- **Expanding paperboard capacity at Kovai:** In India, demand for paperboard is growing at 7-8% versus 2% globally. Demand for value-added paperboard made from ECF (elemental chlorine free) pulp is growing at over 20% per annum. We expect demand for ECF-based paperboard to expand even faster as organized retailing unfolds. ITC is currently adding one more paperboard production line of 90,000 tonnes at its manufacturing unit at Kovai. This will increase ITC's overall paperboard capacity to 400,000 tonnes. The new unit will use waste paper as raw material and be served by 8mW captive power.
- **New writing and printing paper unit at Bhadrachalam:** ITC has embarked on a new 100,000 tonne writing and & printing paper unit at its existing site in Bhadrachalam. The unit will be set up at a cost of Rs11b. ITC plans production of high quality-end paper to be used for its Stationery and Greeting Cards business. The company has plans to concentrate on consumer stationery (writing and printing paper segment) as it can leverage this on its existing brands such as Expressions and Paper Mate. The unit would result in quick ramp up in its stationery business from current levels of Rs1b.

PAPERBOARD DIVISION PERFORMANCE (RS M)

	FY04	FY05	FY06	FY07	FY08E	FY09E
Sales	**12,448**	**15,510**	**18,957**	**20,917**	**22,266**	**24,916**
Sales growth (%)	*7.2*	*24.6*	*22.2*	*10.3*	*6.5*	*11.9*
EBITDA	**3,093**	**3,829**	**4,682**	**5,439**	**5,344**	**6,727**
EBITDA Margins (%)	*24.8*	*24.7*	*24.7*	*26.0*	*24.0*	*27.0*
EBITDA Growth (%)	*3.8*	*23.8*	*22.3*	*16.2*	*-1.8*	*25.9*
*% of Total Sales **	*16.9*	*17.7*	*16.8*	*14.8*	*13.6*	*12.5*
% of EBITDA	*12.6*	*13.1*	*13.1*	*12.9*	*11.7*	*12.5*

** Excluding inter-segment sales* *Source: Company/ Motilal Oswal Securities*

- **Clonal propagation to meet wood requirement:** ITC has adopted a strategy of clonal propagation, whereby it has helped farmers to plant eucalyptus, bamboo, subabul trees etc. The company has increased the covered plantation area from 41,000 hectares in FY06 to 61,000 hectares to end-FY07. The increased crop area will enable the company to source the cost effective wood pulp for its planned expanded capacity.
- **ECF pulp capacity to be doubled:** ITC is currently implementing capacity expansion in elemental chlorine free (ECF) pulp plant from 100,000 tonnes to 200,000 tonnes per annum. ECF pulp-based paperboard is finding growing usage in pharmaceutical and food products industries. ITC plans to increase the production of value added paperboards at Bhadrachalam after the new ECF pulp unit is commissioned. However, the share of value-added pulp in total paperboard sales is likely to remain at 50% as the Kovai unit will focus on the ordinary standard paperboards. Commissioning of

pulp capacity will result in margin expansion as the company would not be dependent on the imported pulp.

- **Soft wood pulp prices likely to decline:** Prices of wood pulp, waste paper and chemical prices have been on an up-trend. Pulp prices have increased by more than 20% during the current year. Paperboard prices have increased risen by 7.9% during the last 12 months from Rs37,000 per tonne to Rs41,000 per tonne currently. Writing and & printing paper prices have increased by 15% during the past 12-15 months. CrisInfac expects wood prices to increase at 6-8% per annum in the forthcoming years, as demand would continue to be strong. ITC expects soft wood pulp prices to soften ahead, which would benefit the company. We note ITC currently outsources 15% of its pulp requirement.
- **Value addition, a key positive:** CrisInfac expects that 2.5m tonne capacity will be added in the paper industry over the next five years, with the writing and & printing segment (accounting for 1.4m tonne), resulting in softer prices owing to excess capacity. In such a scenario, ITC would be well placed, as the company would be utilizing a significant share of the writing and and printing capacity for internal consumption in its Greeting Cards and Stationery division.

We expect the Paper division to record earnings CAGR of 14% over next 2 years

ITC's paper business has reported 4.9% increase in sales and 17% decline in PBIT during 1QFY08 due to inventory destocking in cigarette paper ahead of pictorial warnings implementations and machine rebuilding for capacity expansion. The performance is expected to improve during the second half of the current year. We expect ITC's paper division to post 9.3% and 13.6% CAGR in sales and EBITDA over FY07-FY09.

e-Choupal formats - show of promise

ITC is the pioneer of a unique two-way rural distribution cum sourcing initiative e-Choupal, which has given the company a big headstart in the much talked about second green revolution, aiming to harness huge untapped growth potential in rural India.

e-Choupal format aims to harness huge untapped rural potential

ITC's international business division (IBD), as part of its agri business, exports agricultural commodities, leaf tobacco and fresh fruits. IBD is taking ITC's domestic rural and agri initiative forward with the e-Choupal, Choupal Sagar and Choupal Fresh formats. The company has planned capex of Rs50b over the next 7-10 years for this agri-cum-retail initiative. In sum, ITC caters to the needs of every consumer type - from the well heeled city-bred to the farmer in a remote village earning farm income.

Rural India offers substantial growth potential

Rural India and the agriculture sector entails immense growth potential as agriculture provides employment to more than 60% of the country's population. Corporate India, on the other hand, has been planning large projects based on contract farming and agri-marketing with stalwart companies such as Reliance and Bharti. A.V. Birla and Mahindra too have similar big plans to leverage agri-products.

The unique feature about the rural sector is that it offers two-way benefits in distribution and sourcing of products and services. The GoI has stepped up irrigation spend and projects up to Rs400b are expected to be completed in the next five years. More than 11 states have altered the Agricultural Produce Marketing Committee (APMC) Act, enabling direct sourcing of agricultural produce from farmers, improving farm realizations. Further, the National Horticulture Mission has plans to double milk production to 350+m ton by 2011.

In view of what is stated above, we estimate that a 10% improvement in productivity and realizations can result in Rs500b (US$11b) increase in rural incomes - this can serve to boost rural economy. All the above stated government initiatives gain further support from the growing corporate interest in contract farming, establishment of a cold chain to transport fresh farm produce and marketing and export of high quality agricultural products. To conclude, we believe rural India offers an attractive 2-pronged opportunity: (1) direct sourcing of agri products leading to higher realizations for farmers; and (2) increased marketing of consumer products riding on expected spurt in rural purchasing power.

e-Choupal to be ramped up to 20,000 locations

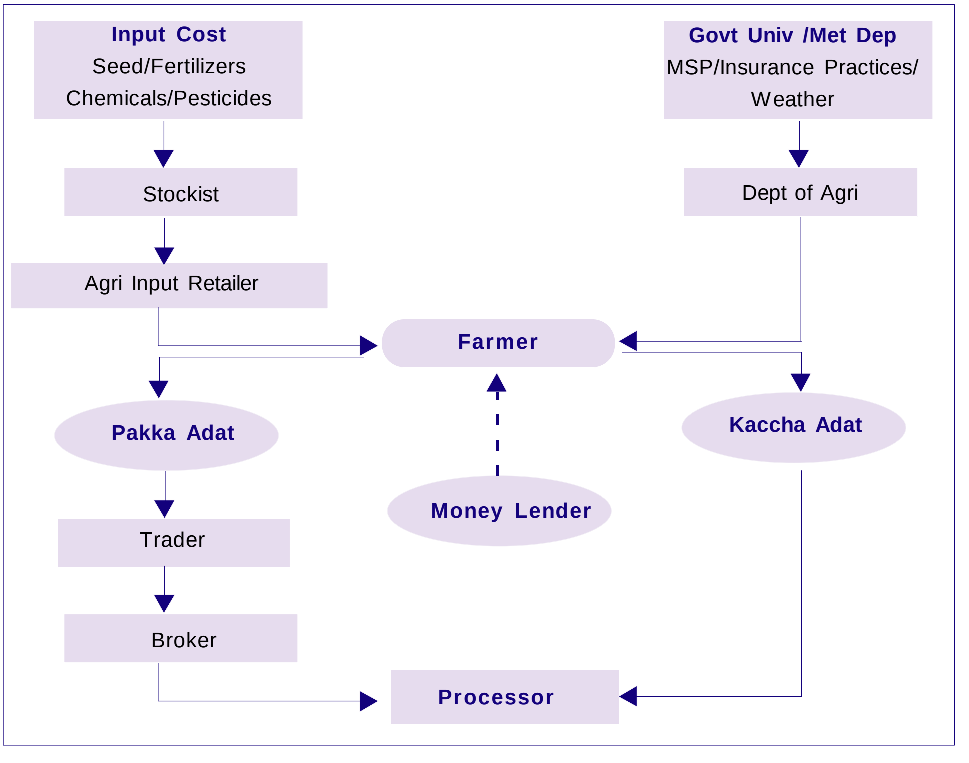
ITC plans to set up 20,000 e-Choupals in next 7-10 years

After success of its e-Choupal model in creating a two-way sourcing cum distribution system in rural India, ITC is currently in the fast ramp-up stage. The number of e-Choupals has been increased to 6,500 with reach to over 3.5m farmers in nearly 40,000 villages. ITC is targeting 20,000 e-Choupals in the next 7-10 years, which would track over 100,000 villages (one-sixths of rural India). ITC also plans to expand to reach 15 states in comparison with nine states currently.

The e-Choupal framework fits well with the company's long-term plan to expand its range of food products as well as retailing of agricultural products. On the one hand, the company saves intermediation costs and on the other, it ensures desirable product quality. Farmers also benefit, as they have easy access to information regarding crops, soil types, weather, crop protection initiatives, and above all, fair prices for their products, all this at their doorstep. ITC is taking this initiative forward with Choupal Sagar and Choupal Fresh, which would serve to complete ITC's comprehensive model for rural India and agriculture.

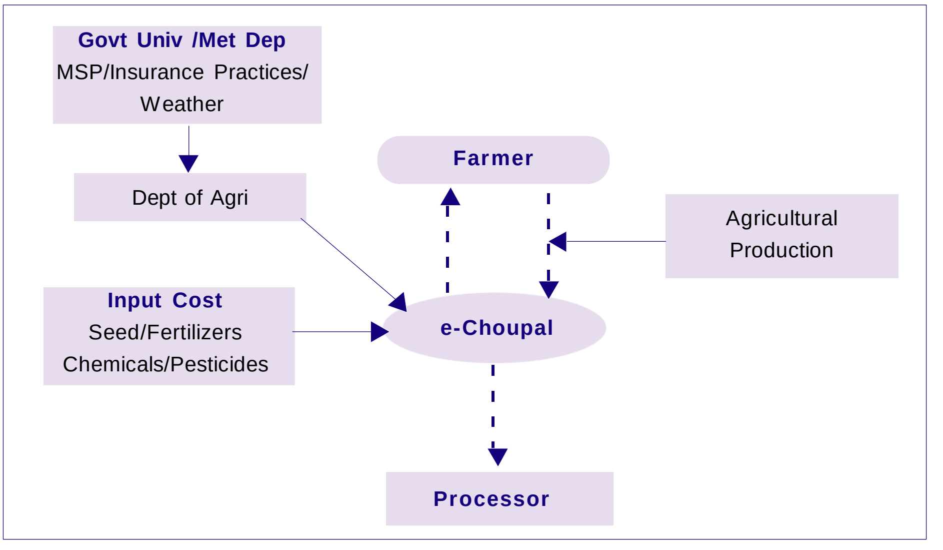
CHOUPAL SAGAR - GIVING RURAL INDIA A TASTE OF ORGANIZED RETAILING

FARM PRODUCE: A TRADITIONAL VALUE CHAIN



Source: Company/ Motilal Oswal Securities

FARM PRODUCE: THE e-CHOUPAL VALUE CHAIN



Source: Company/ Motilal Oswal Securities

How an e-Choupal works?

e-Choupal is an internet based network which is operated in a village by a person called sanchalak, who is appointed by ITC. Farmers can get information about crop pattern, rainfall, seeds and fertilizers etc. from this network. In addition to it farmers can also procure agri input at competitive prices. Once the crop is harvested farmers can bring the crop to the e-Choupal where they can sell the crop to ITC at best prices prevailing in the market which the farmer can check through e-Choupal's internet network.

Number of Choupal Sagars are planned to increase to 40 in next 12 months

Choupal Sagar is a rural hypermart and serves as an extension of ITC's rural distribution strategy. ITC is already operating 11 Choupal Sagars across Uttar Pradesh, Madhya Pradesh and Maharashtra. Nine more Choupal Sagars are in advanced stage of being set up with operations expected to commence in the next one or two quarters. The company plans to increase the number of Choupal Sagars to 40 in the next 12 months.

ITC has positioned Choupal Sagar as a one-stop shop for warehousing of agri produce, fuel station, health, soil testing, banking, food court and tractor servicing. The Sagars will also sell agri inputs, apparel, grocery, durables, toys, music etc. with Uttam Quality, Sahi Jaankari, and Kam Daam. The company has an alliance with one of its clients, Merubeni, whereby Merubeni and ITC will work together to explore new products and opportunities whereby ITC will gain from the expertise of Merubeni in setting up a strong back-end and warehouses. We expect ITC to commission up to 60 Choupal Sagars by FY09, yielding annual sales of Rs2.7b.

Choupal Fresh - end-to-end solution

ITC has further extended its rural integration strategy with the launch of Choupal Fresh Stores. These are pilot stores that market fresh fruits and vegetables. Whilst the company is currently examining this concept with an objective to add value in the entire system, three such stores have been set up at Pune, Hyderabad and Chandigarh. ITC is aided in this project by three consortium partners - Snowman (logistics), Mitsubishi (cold chain) and US Aid Agency (crop calendaring and best agricultural practices).

These stores operate as 'cash-and-carry' stores during the early morning for retail traders, and later in the day, they are open for retail consumers. Each store is spread over an area of 2,500sq. ft. in the front end and has a warehouse at the back end, spread over an area of 7,500 sq. ft. We believe the potential in this area of activity is likely huge assuming a population of 200m in the top 20 cities in India - the target market being 30% and the average spend on fruit and vegetables at Rs100 per week per person - we arrive at a market value of Rs312b.

AGRI BUSINESS & CHOUPAL SAGAR PERFORMANCE (RS M)

	FY04	FY05	FY06	FY07	FY08E	FY09E
Sales	**17,066**	**17,666**	**26,784**	**36,914**	**48,321**	**62,059**
Sales Growth (%)	*3*	*4*	*52*	*38*	*31*	*28*
EBITDA	**1,099**	**1,243**	**1,238**	**1,604**	**1,981**	**2,358**
EBITDA Margins (%)	*6.4*	*7.0*	*4.6*	*4.3*	*4.1*	*3.8*
EBITDA Growth (%)	*8.2*	*13.1*	*-0.4*	*29.5*	*23.5*	*19.0*
% of Total Sales	*23.1*	*20.1*	*23.8*	*26.1*	*29.6*	*31.1*
% of EBITDA	*4.5*	*4.3*	*3.5*	*3.8*	*4.3*	*4.4*

Source: Company/Motilal Oswal Securities

Hotels: Limited headroom

The higher increase in room demand versus capacity increase over the past 2-3 years has led to an increase in ITC's occupancy levels to 73% from 55% and an increase in ARR by 20-40%. The buoyant earnings increase has resulted in ITC's Hotel division being a star performer.

The Hotel division is a star performer

HOTELS DIVISION PERFORMANCE (RS M)

	FY04	FY05	FY06	FY07	FY08E	FY09E
Sales	**2,545**	**5,730**	**7,834**	**9,787**	**11,353**	**13,056**
Growth Rate (%)	*32.5*	*125.2*	*36.7*	*24.9*	*16.0*	*15.0*
EBITDA	**628**	**1,937**	**3,303**	**4,218**	**4,882**	**5,484**
EBITDA Margins (%)	*24.7*	*33.8*	*42.2*	*43.1*	*43.0*	*42.0*
EBITDA Growth (%)	*98.2*	*208.6*	*70.5*	*27.7*	*15.7*	*12.3*
% of Total Sales	*3.0*	*5.8*	*6.1*	*6.1*	*6.3*	*5.9*
% of EBITDA	*2.6*	*6.6*	*9.2*	*10.0*	*10.7*	*10.2*

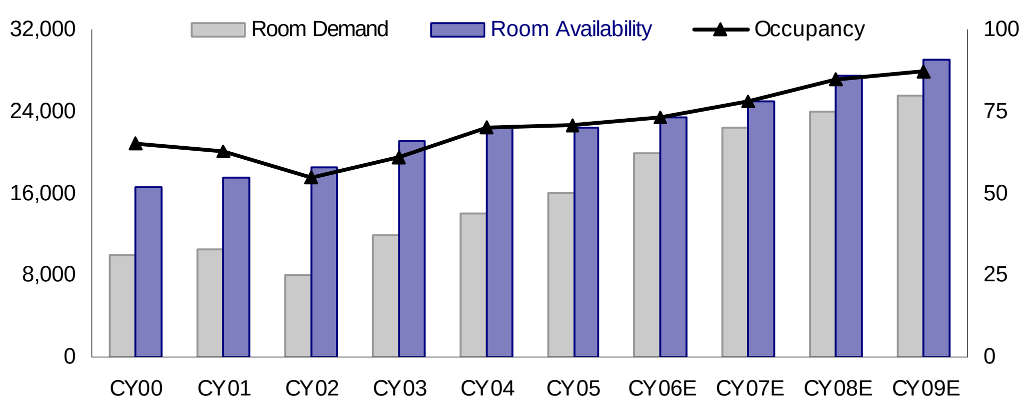
Source: Company/ Motilal Oswal Securities

Strong growth in occupancy levels and ARR continues

Room addition not in line with demand

Demand for hotel rooms has been growing steadily, while room addition has not kept pace with demand. However, the gap between room availability and room demand has narrowed considerably in the current year. The current year's figures indicate steady-to-positive growth in occupancy rates. But we believe that the occupancy levels have risen significantly from 55% in FY02 to current levels of nearly 75%; hence we conclude future increases in occupancy levels will be far slower, particularly as room availability is also expected to improve in the forthcoming 12-18 months.

GAP BETWEEN ROOM AVAILABILITY AND DEMAND HAS NARROWED (NOS)

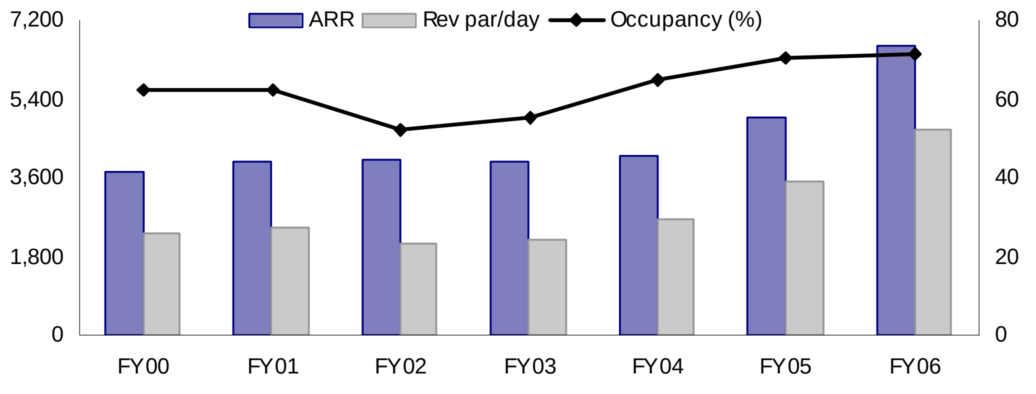


Source: Crisinfac/Motilal Oswal Securities

Rising occupancy levels have resulted in a sharp increase in average revenue per room (ARR) and revenue per day per room. ARR has increased by 20-60% during CY06, the highest increase being in Pune. Rising tourist inflow and a strong economy will result in strong room demand growth and steady 12-15% ARR increase over the next two years.

We expect ARRs to increase steadily by 12-15% over next 2 years

ROOM RENTS HAVE INCREASED WITH RISING OCCUPANCY RATES (RS)



Source: Crisinfac/Motilal Oswal Securities

ITC flags off investment phase

ITC is currently in an expansion mode

The buoyancy in the hotel industry since the past three years has contributed significantly to earnings of ITC's hotel segment. This division recorded an increase of 25.8% in sales and 27.7% in EBITDA in FY07. The company has nine owned, three licensed and four properties under the head 'operating services'. Prominent among these are ITC Maurya Sheraton in New Delhi - 516 rooms; Grand Maratha in Mumbai - 386 rooms; and Sonar Bangla in Kolkata - 239 rooms.

ITC is currently in an expansion mode and has plans to increase overall room capacity by 40% (1,100-1,200 rooms) in the next five years. The company has started construction of a 250-room hotel in Bangalore, which is expected to commence operations in December 2008. The Chennai and Hyderabad properties are expected to start operations by end-CY09 and end-CY10 respectively. ITC's Bangalore property is expected to commence operations in FY09; however this coincides with expected decline in ARR in Bangalore due to commissioning of several properties. The company expects to neutralize the impact due to additional rooms from the new property. The company is positive on the ARR outlook although there might be corrections in various cities from time to time in line with the commissioning of new properties. We expect ARR-led growth to continue for the forthcoming two years, although at a much slower rate.

HOTEL EXPANSIONS

LOCATION	PROPERTY & NO OF ROOMS	2001-02	2002-03	2003-04	2004-05	2005-06
Agra	Welcomgroup Mughal Sheraton	285	285	285	285	285
Bangalore	ITC Windsor Manor Sheraton	240	240	240	240	240
Chennai	ITC Park Sheraton	283	283	283	283	283
Chennai	Welcomgroup Chola Sheraton	92	92	92	92	92
Delhi	ITC Maurya Sheraton	515	515	515	515	515
Hyderabad	ITC Kakatiya Sheraton	188	188	188	188	188
Jaipur	Welcomgroup Rajputana Palace Sheraton	216	216	216	216	216
Vadodara	Welcomgroup Vadodara	134	134	134	134	134
Mumbai	ITC Hotel Grand Maratha Sheraton & Towers	386	386	386	386	386
Mumbai	ITC Hotel Grand Central Sheraton & Towers	-	-	-	60	242
Kolkata	ITC Hotel Sonar Bangla Sheraton & Towers	-	239	239	239	239
Total		**2,339**	**2,578**	**2,578**	**2,638**	**2,820**

Source: Crisinfac/Motilal Oswal Securities

The hotels business has reported 11.3% increase in sales and 11.7% increase in net profit for 1QFY08. Currency appreciation and the transition phase of re-branding several properties from brand, Sheraton to brand, Starwood as well as luxury tax collection has impacted performance. Management expects performance to improve in forthcoming quarters, as the industry has started charging rupee-denominated room rentals. We expect the hotels division to post sales and EBITDA CAGR of 15% and 14% over FY07-FY09, as we believe that the medium term growth rates have been achieved.

Valuations are attractive

The stock has underperformed the BSE Sensex by 39% over the last 12 months owing to uncertainty of cigarette volumes over levy of VAT. Given the company's strong free cash flows, popular brands, market leadership in key businesses and the potential offered by its e-Choupal initiative, we believe that the stock is attractive and ITC continues to be a preferred play on the domestic consumption basket. We maintain **Buy**, with an SOTP-based target price of Rs203, a 33% upside.

Our SOTP valuation implies 33% upside

Our SOTP valuation includes 33% upside. Buy with our target price of Rs203

We have valued ITC on the basis of sum-of-the-parts (SOTP). Our assumptions are:

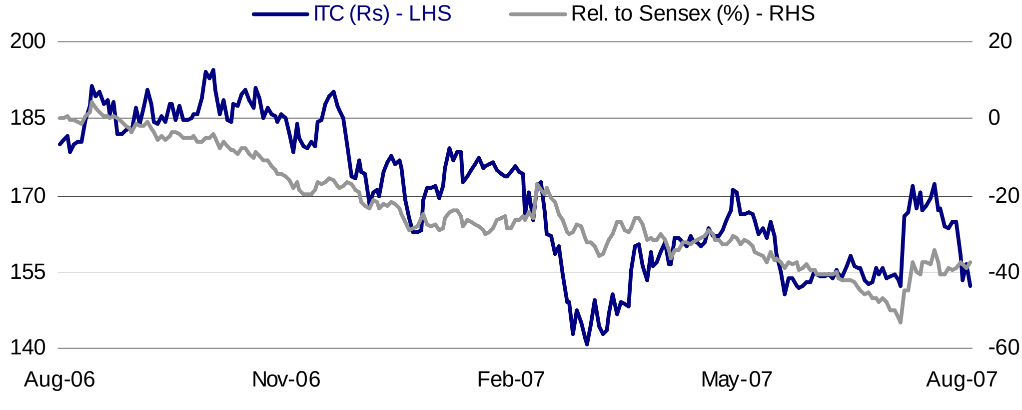
- Cigarettes - we have valued ITC's cigarette business at 14x FY09 EV/EBITDA. We have assumed 25% discount to HUL's EV/EBITDA
- Paper - we have assumed EV/EBITDA of 4x, which is in line with that of market leader, BILT despite ITC's superiority arising from ECF-based pulp and strong presence in specialty papers and packaging for food and pharmaceuticals, a high potential area
- Agri business 3.5xFY09 EV/EBITDA - no comparable benchmark; we have assigned the EV/EBITDA that commodity sectors enjoy
- New FMCG businesses - valued at 2x sales, 30% discount to peers, discount taken primarily due to initial losses despite strong brands and market positioning in biscuits, snacks, wheat flour, lifestyle retailing, greeting cards, school notebooks and matchboxes
- Hotels - valued at EV/EBITDA of 6.5x, 10% discount to market leader despite ITC controlling some prime properties and is the fastest growing hotel chain in India
- Choupal Sagar - 2x sales, given the strong headstart in rural areas, with huge forward and backward linkages with ITC's other products.

SOTP VALUATION HAS TARGET PRICE OF RS203

	GROSS SALES	EBITDA	BASIS	MULTIPLE	VALUE	RATIONALE
Cigarettes	165,599	40,192	EV/EBITDA	14.0	562,687	
New FMCG	36,720	-826	2x Sales	2.0	73,440	30% discount to peers
Hotels	13,056	5,484	EV/EBITDA	6.5	35,643	10% discount to market leader
Paper	15,210	6,727	EV/EBITDA	4.0	26,910	In line with market leader Bilt
Agri	46,423	2,298	EV/EBITDA	3.5	8,044	
Choupal Sagar	2,003		1.5x Sales	1.0	2,003	
Investments					54,158	
Total (Rs m)					**762,884**	
Value per Share (Rs)					203	
Current Market Price (Rs)					152	
Upside (%)					33	

Source: Motilal Oswal Securities

STOCK PERFORMANCE (1 YEAR)



ITC: SEGMENTAL PERFORMANCE (RS MILLION)

	FY04	FY05	FY06	FY07	FY08E	FY09E
Net Sales						
Cigarettes	39,664	44,608	51,047	59,134	57,884	65,353
New FMCG	3,144	5,903	10,135	17,101	25,977	36,720
Hotels	2,248	5,062	6,926	8,711	10,290	11,861
Agri Business	17,066	17,666	26,784	36,914	48,321	62,059
Paperboard, Paper and Packaging	11,687	14,492	17,773	19,901	21,173	23,694
Sales Growth (%)						
Cigarettes	7.5	12.5	14.4	15.8	-2.1	12.9
New FMCG	184.6	87.7	71.7	68.7	51.9	41.4
Hotels	32.5	125.2	36.7	24.9	16.0	15.0
Agri Business	2.9	3.5	51.6	37.8	30.9	28.4
Paperboard, Paper and Packaging	7.2	24.6	22.2	10.3	6.5	11.9
EBITDA						
Cigarettes	21,349	24,041	28,157	32,796	35,020	40,192
New FMCG	-1,694	-1,882	-1,582	-1,821	-1,559	-826
Hotels	628	1,937	3,303	4,218	4,882	5,484
Agri Business	1,099	1,243	1,238	1,604	1,981	2,358
Paperboard, Paper and Packaging	3,093	3,829	4,682	5,439	5,344	6,727
					7%	15%
EBITDA Margin (%)						
Cigarettes	53.8	53.9	55.2	55.5	60.5	61.5
New FMCG	-53.9	-31.9	-15.6	-10.7	-6.0	-2.3
Hotels	24.7	33.8	42.2	43.1	43.0	42.0
Agri Business	6.4	7.0	4.6	4.3	4.1	3.8
Paperboard, Paper and Packaging	24.8	24.7	24.7	26.0	24.0	27.0
Sales Contribution (%)						
Cigarettes	53.7	50.8	45.3	41.7	35.4	32.8
New FMCG	4.3	6.7	9.0	12.1	15.9	18.4
Hotels	3.0	5.8	6.1	6.1	6.3	5.9
Agri Business	23.1	20.1	23.8	26.1	29.6	31.1
Paperboard, Paper and Packaging	15.8	16.5	15.8	14.0	13.0	11.9

E: MOSt Estimates

INCOME STATEMENT					(RS MILLION)
Y/E MARCH	2005	2006E	2007	2008E	2009E
Net Sales	**76,395**	**97,905**	**123,693**	**142,347**	**174,017**
Change (%)	*18.5*	*28.2*	*26.3*	*15.1*	*22.2*
Total Expenditure	**-48,438**	**-64,578**	**-84,129**	**-99,377**	**-123,018**
EBITDA	**27,957**	**33,327**	**39,564**	**42,971**	**50,999**
Change (%)	*18.2*	*19.2*	*18.7*	*8.6*	*18.7*
Margin (%)	*36.6*	*34.0*	*32.0*	*30.2*	*29.3*
Depreciation	-3,129	-3,323	-3,629	-3,970	-4,490
Int. and Fin. Charges	-508	-211	-33	-80	-80
Other Income - Recurring	2,411	2,899	3,365	3,836	4,239
Profit before Taxes	**26,731**	**32,692**	**39,267**	**42,757**	**50,668**
Change (%)	*15.3*	*22.3*	*20.1*	*8.9*	*18.5*
Margin (%)	*35.0*	*33.4*	*31.7*	*30.0*	*29.1*
Tax	-7,879	-10,584	-12,267	-14,024	-16,619
Deferred Tax	-481	696	0	898	1,064
Tax Rate (%)	*-31.3*	*-30.2*	*-31.2*	*-30.7*	*-30.7*
Profit after Taxes	**18,371**	**22,804**	**27,000**	**29,374**	**34,809**
Change (%)	*15.4*	*24.1*	*18.4*	*8.8*	*18.5*
Margin (%)	*24.0*	*23.3*	*21.8*	*20.6*	*20.0*
Non-rec. (Exp)/Income	3,543	-450	0	0	0
Reported PAT	**18,371**	**22,353**	**27,000**	**29,374**	**34,809**

E: MOSt Estimates

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Share Capital	2,482	3,755	3,762	3,762	3,762
Reserves	76,474	86,860	100,609	114,833	131,281
Net Worth	**78,956**	**90,615**	**104,371**	**118,595**	**135,043**
Loans	2,454	1,197	2,009	2,009	2,009
Deferred Liability	3,761	3,248	4,729	5,442	6,308
Capital Employed	**85,171**	**95,060**	**111,108**	**126,046**	**143,359**
Gross Block	57,463	62,272	71,343	76,343	86,343
Less: Accum. Depn.	-17,955	-20,654	-23,895	-27,865	-32,355
Net Fixed Assets	**39,508**	**41,617**	**47,448**	**48,478**	**53,988**
Capital WIP	1,862	2,434	8,661	15,000	6,000
Investments	38,747	35,170	30,678	36,091	54,241
Curr. Assets, L&A	**35,393**	**51,619**	**62,897**	**69,532**	**80,896**
Inventory	20,030	26,363	33,540	39,725	48,044
Account Receivables	5,278	5,480	6,367	6,630	7,628
Cash and Bank Balance	557	8,558	9,002	8,172	8,512
Others	9,529	11,218	13,988	15,006	16,712
Curr. Liab. and Prov.	**30,338**	**35,781**	**38,576**	**43,055**	**51,765**
Account Payables	18,920	21,484	23,434	26,285	31,619
Other Liabilities	2,171	2,674	3,478	3,821	4,452
Provisions	9,247	11,622	11,664	12,950	15,694
Net Current Assets	**5,055**	**15,838**	**24,321**	**26,477**	**29,130**
Application of Funds	**85,171**	**95,060**	**111,108**	**126,046**	**143,359**

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006E	2007E	2008E	2009E
Basic (Rs)					
EPS	**4.9**	**6.1**	**7.2**	**7.8**	**9.3**
Cash EPS	5.7	7.0	8.2	8.9	10.5
BV/Share	21.0	24.1	27.8	31.6	36.0
DPS	2.0	2.6	3.1	3.4	4.2
Payout %	41.9	43.6	43.3	44.1	45.1
Valuation (x)					
P/E		25.1	21.2	19.5	16.5
Cash P/E		21.9	18.7	17.2	14.6
EV/Sales		5.4	4.3	3.7	2.9
EV/EBITDA		15.9	13.5	12.3	10.0
P/BV		6.3	5.5	4.8	4.2
Dividend Yield (%)		1.7	2.0	2.3	2.7
Return Ratios (%)					
RoE	23.3	25.2	25.9	24.8	25.8
RoCE	32.0	34.6	35.4	34.0	35.4
Working Capital Ratios					
Debtor (Days)	25	20	19	17	16
Asset Turnover (x)	0.9	1.0	1.1	1.1	1.2
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

E: MOSt Estimates

CASH FLOW STATEMENT (RS MILLION)

Y/E MARCH	2005	2006E	2007E	2008E	2009E
OP/(loss) before Tax	24,828	30,004	35,935	39,001	46,509
Int./Div. Received	2,411	2,899	3,365	3,836	4,239
Depreciation and Amort.	3,129	3,323	3,629	3,970	4,490
Interest Paid	-508	-211	-33	-80	-80
Direct Taxes Paid	-7,879	-10,584	-12,267	-14,024	-16,619
(Incr)/Decr in WC	-5,311	-2,782	-8,040	-2,986	-2,314
Deff Tax	2,884	-513	1,481	713	866
CF from Operations	**19,554**	**22,136**	**24,070**	**30,430**	**37,091**
(Incr)/Decr in FA	-8,777	-5,382	-15,299	-11,339	-1,000
(Pur)/Sale of Investments	-8,207	3,577	4,492	-5,413	-18,150
CF from Invest.	**-16,985**	**-1,804**	**-10,805**	**-16,751**	**-19,148**
Issue of Shares	872	650	424	0	0
(Incr)/Decr in Debt	1,245	-1,256	812	0	0
Dividend Paid	-8,792	-11,347	-13,645	-15,150	-18,361
Exceptional Income	3,543	-450	0	0	0
Others	780	72	-411	641	759
CF from Fin. Activity	**-2,352**	**-12,331**	**-12,821**	**-14,509**	**-17,602**
Incr/Decr of Cash	**217**	**8,001**	**444**	**-829**	**341**
Add: Opening Balance	340	557	8,558	9,002	8,172
Closing Balance	**557**	**8,558**	**9,002**	**8,172**	**8,512**

E: MOSt Estimates

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