

ITC Limited (ITC)

₹ 209

Rating matrix

Rating	:	Buy
Target	:	₹ 230
Target Period	:	12-15 months
Potential Upside	:	10%

Key Financials

₹ Crore	FY10	FY11	FY12E	FY13E
Net Sales	18,153	21,167.6	23,928.5	27,702.9
EBITDA	34.3	34.7	35.4	35.6
Net Profit	4,061.0	4,987.6	5,769.8	6,665.1
EPS (Rs)	5.2	6.4	7.5	8.6

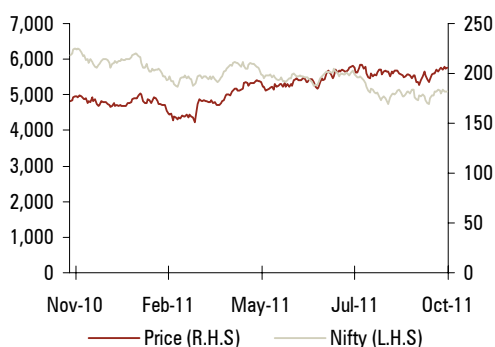
Valuation summary

	FY11	FY12E	FY13E	FY14E
P/E	32.4	28.0	24.3	20.7
Target P/E	35.7	30.9	26.7	22.8
Dividend yield	2.1	2.5	2.8	2.9
Price/Sales	7.6	6.8	5.8	5.1
RoNW	31.3	33.9	36.3	37.7

Stock data

Market Capitalization	161,727.2
Total Debt (FY11)	99.2
Cash and Investments (FY11)	6,230.1
EV	155,596.3
52 week H/L	209 / 151
Equity capital	773.8
Face value	Rs 1
MF Holding (%)	35.2
FII Holding (%)	15.3

Price movement



Analyst's name

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WHAT'S CHANGED...

PRICE TARGET	Changed from ₹ 226 to ₹ 230
EPS (FY09E)	Changed from ₹ 7.3 to ₹ 7.5
EPS (FY10E)	Unchanged
RATING	Unchanged

Strong performance; reiterate Buy...

ITC posted strong Q2FY12 results with topline growth of 23.2% to ₹ 5974.2 crore from ₹ 4850.7 crore in Q2FY11 on the back of 14% increase in the cigarettes revenue. The cigarettes business witnessed a second consecutive quarter of ~7% + volume growth. EBITDA margins were at 36.5% on the back of increasing margins in the cigarettes business and reduction in losses in the FMCG segment. Other income increased ~45% to ₹ 180.8 crore led by income from investments. Higher EBITDA and other income further boosted net profits by 21.4% to ₹ 1514.3 crore.

Segmental results

Cigarettes revenues grew 14% to ₹ 5485.9 crore on the back of strong volume growth of 7% and 6.5% price hikes. ITC took price hikes in August-September after some states increased VAT on cigarettes. The FMCG segment witnessed healthy growth of 27% and agri and paper segment also witnessed 12% and 10% revenue growth. However, the hotels segments grew by a mere 4% due to a slowdown in developed economies (which contributes ~30% of tourist arrivals) and lower discretionary spend by corporates.

Valuation

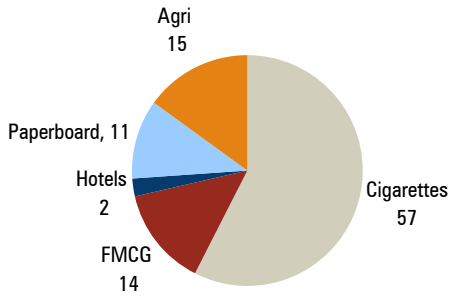
We believe despite the possibility of a steep excise duty increase in Budget 2012, pricing power in cigarettes would continue to result in improvement in margins. Simultaneously, a reduction in losses in the FMCG business would also aid overall margins. We have valued the stock on an SOTP basis and arrived at a fair value of ₹ 230/share. Our target price is based on valuing the cigarettes business at ₹ 183/share, other businesses at ₹ 39/share and cash/share of ₹ 8. Moreover, at the CMP of ₹ 209, the stock is trading at 24.3x its FY13E and 20.7x its FY14E EPS of ₹ 8.6 and ₹ 10.1, respectively. With the historic trading range for ITC being 15-28x and our target P/E being 26x FY13E, our valuation is justified.

Exhibit 1: Financial Performance

(₹ Crore)	Q2FY12	Q2FY12E	Q2FY11	Q1FY12	QoQ (Chg %)	YoY (Chg %)
Net Sales	5974.2	5937.0	4850.7	5767.5	3.6	23.2
EBITDA	2219.0	2095.6	1875.6	1977.1	12.2	18.3
EBITDA Margin (%)	36.5	35.3	38.0	33.7	273 bps	-153 bps
Depreciation	170.1	169.8	164.0	166.5	2.2	3.7
Interest	14.2	12.7	5.4	16.5	-13.8	164.6
Other Income	180.8	134.3	124.5	143.8	25.7	45.2
Reported PAT	1514.3	1386.1	1247.4	1333.7	13.5	21.4
EPS (₹)	1.9	1.8	1.6	1.7	13.0	20.9

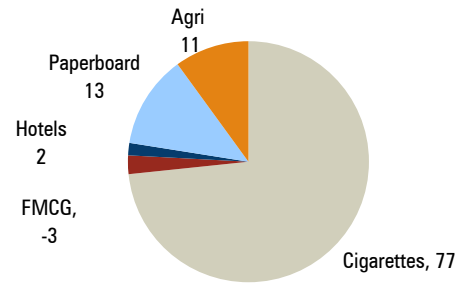
Source: Company, ICICIdirect.com Research

Exhibit 2: Revenues contribution (%)



Source: Company, ICICIdirect.com, Research

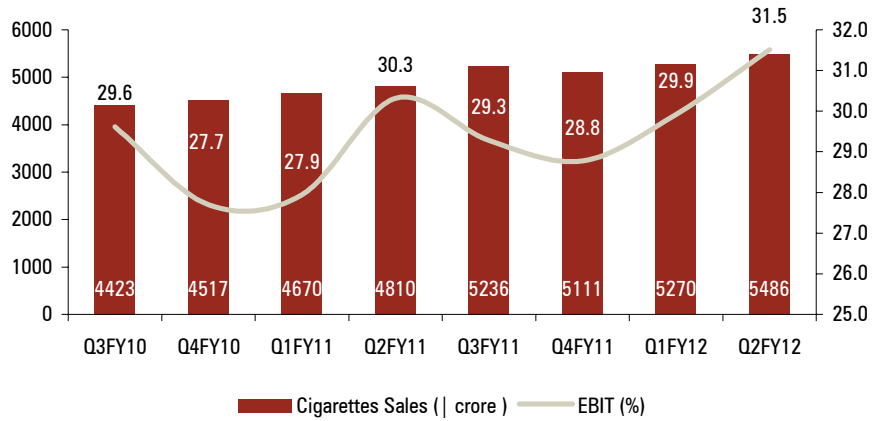
Exhibit 3: EBIT contribution (%)



Source: Company, ICICIdirect.com, Research

Strong sales growth with increasing margins have enhanced earnings

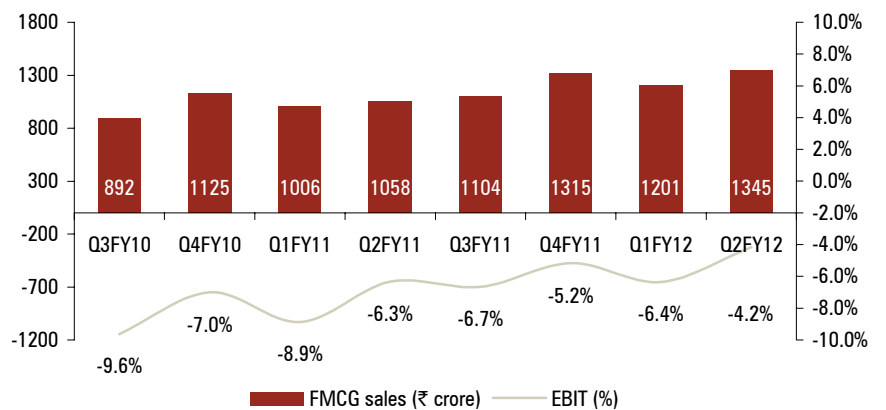
Exhibit 4: Cigarettes revenues and EBIT (%)



Source: Company, ICICIdirect.com Research

Robust growth in FMCG sales and continuous reduction in losses are positives to drive topline growth and improve overall margins

Exhibit 5: FMCG sales and EBIT (%) trend

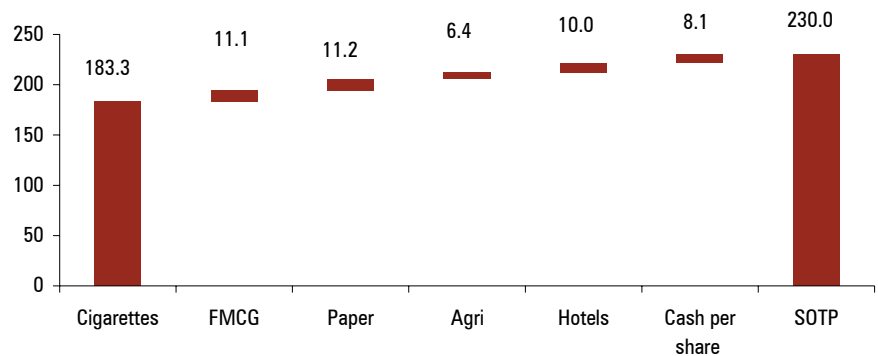


Source: Company, ICICIdirect.com Research

Valuation

We have valued ITC on the basis of sum of the part (SOTP) valuation. Our fair value for the stock comes to ₹ 230 per share. With the cigarettes business contributing almost ~59% to revenues and ~77% to EBITDA, it accounts for maximum (81%) value. We expect a moderate volume growth and sustained price hike in the segment to continue to drive revenue growth and expansion in margins. Therefore, we have valued the cigarettes business at ₹ 183, 26x its FY13E EPS of ₹ 7.

Exhibit 6: SOTP valuation (₹ per share)



Source: Company, ICICIdirect.com Research

Considering a consistent reduction in losses in the FMCG segment led by the break-even in the foods business (except noodles), the company's overall margins would improve, going forward. However, the personal care segment continues to remain a drag given intense competition. We have valued the FMCG business at ₹ 11 per share, 1.2x its price to sales.

We have valued the paper business at 6x its EV/EBITDA per share of ₹ 11.2 given its leadership position in specialty papers, which is a high margins business. Strong volume growth of ~8% and ~5% price led growth would result in higher revenue growth in the segment. We have valued the agri business at 2x its EV/EBITDA at ₹ 6 per share.

With the expected increase in room capacity from 3,014 (owned) in FY11 to 4,208 in FY14E, the hotels business accounts for highest (₹ 1500 crore out of ₹ 5000 crore in the next three years) capex of all businesses. Given the company's presence in five star properties, we believe that it should command a premium to Indian Hotels (1.8x EV/room). We have valued the hotels business at 2x EV per room arriving at a price of ₹ 10 per share. The company has cash and liquid investment worth ₹ 6234.6 crore that accounts for ₹ 8 per share.

Exhibit 7: Sum of the parts valuation

SOTP Value		Based on FY13E earnings
Cigarettes	183.3	26x Price to Earning multiple
FMCG	11.1	1.2x Price to sales
Paper	11.2	6x EV / EBITDA
Agri	6.4	2x Price to Book
Hotels	10.0	2x EV / Room capacity
Cash	8.1	Includes cash and Liquid Investment
Target Price	230.0	

Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

					Sales (₹ crore)	EPS (₹)	PE (x)	EV/E (x)	RoNW (%)	RoCE (%)
Asian Paints										
Idirect Code	ASIPAI	CMP	3060	FY11	7706.2	87.9	34.8	22.4	57.6	54.5
		Target	3390	FY12E	9111.1	100.6	30.4	20.3	49.5	49.7
MCap	29351.5	Upside	11%	FY13E	10011.7	128.3	23.9	16.2	51.3	49.7
Dabur India										
Idirect Code	DABIND	CMP	96	FY11	4077.4	3.3	29.4	23.0	48.9	41.1
		Target	113	FY12E	5061.4	3.6	26.8	23.0	37.6	30.4
MCap	18103.3	Upside	18%	FY13E	5895.4	4.5	21.2	18.5	34.6	31.7
ITC										
Idirect Code	ITC	CMP	209	FY11	21167.6	6.4	32.4	20.5	31.3	42.3
		Target	230	FY12E	23928.5	7.5	28.0	17.7	33.9	46.5
MCap	158632.0	Upside	10%	FY13E	27702.9	8.6	24.3	15.3	36.3	50.4
Jyothy Laboratories										
Idirect Code	JYOLAB	CMP	133	FY11	619.5	6.6	20.2	15.0	10.9	8.5
		Target	161	FY12E	604.5	3.4	39.0	15.8	11.3	3.8
MCap	1499.8	Upside	21%	FY13E	662.8	4.7	28.6	14.1	12.2	7.3
Kansai Nerolac										
Idirect Code	GOONER	CMP	840	FY11	2138.7	41.6	20.2	16.3	22.5	24.1
		Target	1048	FY12E	2568.7	43.8	19.2	12.6	20.8	25.6
MCap	4688.6	Upside	25%	FY13E	2891.7	50.8	16.5	10.9	19.1	24.1
Marico										
Idirect Code	MARIN	CMP	156	FY11	3128.3	4.7	33.4	25.2	36.5	29.1
		Target	158	FY12E	4079.9	5.5	28.3	20.7	31.7	26.4
MCap	9771.5	Upside	2%	FY13E	4921.3	6.9	22.6	16.2	30.2	29.2

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: > 15%/20% for large caps / midcaps, respectively;
Buy: Between 10% and 15%/20% for large caps / midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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