October 20, 2011

ITC Limited (ITC)

₹ 205

Cigarettes: Injurious to health, not investments…

ITC is the largest cigarette manufacturer and among the largest paperboard manufacturing companies in India. The company also has the second largest hotel chain in the country and is aggressively acquiring a strong position in the FMCG space. Being the market leader in cigarettes (83% value share in FY11), it has strong pricing power and brand value with a well established distribution network, thereby helping it to derive strength in other businesses also. Further, an increasing dividend payout over the years (from ~40% in FY06 to ~70% in FY11) has kept the return ratios of ITC at a good stead and justifies the current valuations. We are initiating coverage on the stock with a BUY rating.

- **Favourable revenue growth across all businesses**

With a leading position in its various businesses, we expect ITC to sustain its gross revenue growth at 12.6% CAGR in FY11-14E. This will be driven by healthy growth in FMCG (18.6%), agri business (16.3%) and paperboards (13.7%) with a moderate growth in cigarette (10.1%) and hotel (8.8%) revenues. Over the last five years, the company's gross revenues have grown at 12.5% (CAGR F07-FY11) from ₹ 21110.2 crore to ₹ 33802.2 crore. This growth was also led by expansion in revenues across businesses with cigarettes (11.5%), FMCG (27.3%) and paperboards (14.9%) being the growth drivers and hotel (2.2%) and agri business (7.9%) revenues witnessing moderate growth.

- **Market leadership to continue driving revenues in cigarette**

ITC is the market leader in the Indian cigarettes industry and enjoys ~75% volume share (FY11). Its cigarette revenues (gross) have grown by ~1.5x, from ₹ 12833.7 crore in FY07 to ₹ 19827.6 crore in FY11, largely driven by price growth of 11.3% with volume growth remaining flat. Being a dominant player, passing on the impact of higher taxes through price increases has not been tough for ITC. Therefore, we expect revenues from cigarettes to continue growing at a CAGR of 10.1% (FY11-14E) driven by 5.3% price growth and a lower volume growth of 4.5%.

Valuation

Led by the diversified nature of ITC's businesses we have valued it on SOTP basis and arrived at a fair value of ₹ 226/share. Our target price is based on valuing cigarettes business at ₹ 183.1/share, other businesses at ₹ 35.3/share and cash/share of ₹ 8.1. Moreover, at CMP of ₹ 204, the stock is trading at 23.7x its FY13E and 20.1x 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. Also, on the basis of DCF valuation, we have arrived at the fair value of ₹ 225 per share.

Exhibit 1: Financial Performance

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales	18,153.2	21,167.6	23,891.1	27,702.9	31,822.1
EBITDA Margin (%)	34.3	34.7	34.9	35.6	36.2
PAT	4,061.0	4,987.6	5,641.3	6,666.0	7,808.7
EPS (₹)	5.2	6.4	7.3	8.6	10.1
P/E (x)	39.1	31.8	28.1	23.8	20.3
Price/Sales	8.7	7.5	6.6	5.7	5.0
Dividend yield	2.4	2.2	2.5	2.9	2.9
RoE (%)	28.9	31.3	33.4	36.6	37.9

Source: Company, ICICIdirect.com Research

Rating Matrix

Rating	:	Buy
Target	:	₹ 226
Target Period	:	12-15 months
Potential Upside	:	10%

YoY Growth (%)

	FY11	FY12E	FY13E	FY14E
Net Sales	16.6	12.9	16.0	14.9
EBITDA	1.2	0.6	1.8	1.8
Net Profit	22.8	13.1	18.2	17.1
EPS	22.8	13.1	18.2	17.1

Current & target multiple

	FY11	FY12E	FY13E	FY14E
P/E	31.8	28.1	23.8	20.3
Target P/E	35.1	31.1	26.3	22.4
Dividend yield	2.2	2.5	2.9	2.9
Price/Sales	7.5	6.6	5.7	5.0
RoNW	31.3	33.4	36.6	37.9

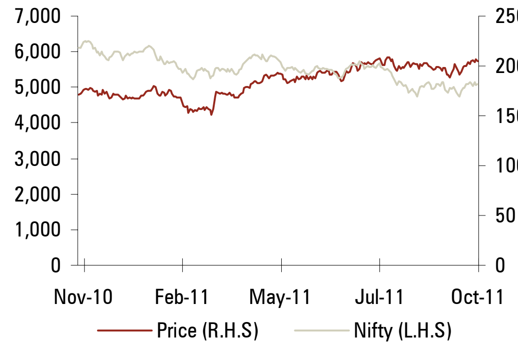
Stock Data

Bloomberg/Reuters Code	ITC.BO / ITC.NS
Sensex	16,936.9
Average volumes	618,169.0
Market Cap (Rs crore)	158,632.0
52 week H/L	209 / 151
Equity Capital (Rs crore)	773.8
Promoter's Stake (%)	-
FII Holding (%)	15.3
DII Holding (%)	35.2

Comparative return matrix (%)

Return %	1M	3M	6M	12M
ITC	6.0	1.5	10.5	21.5
HUL	(1.9)	0.2	19.6	11.6
Nestle India	(2.4)	(6.3)	10.6	24.4
Britannia	(0.8)	(7.6)	21.0	6.6

Price movement



Analyst's name

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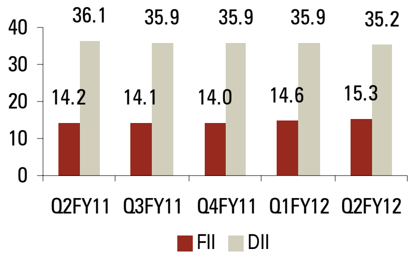
Shareholding pattern (FY11)

Shareholder	Holding
Promoters	-
Institutional Shareholding	49.9
BAT	31.2
Public & Others	18.9

FII & DII holding trend (%)



Company background

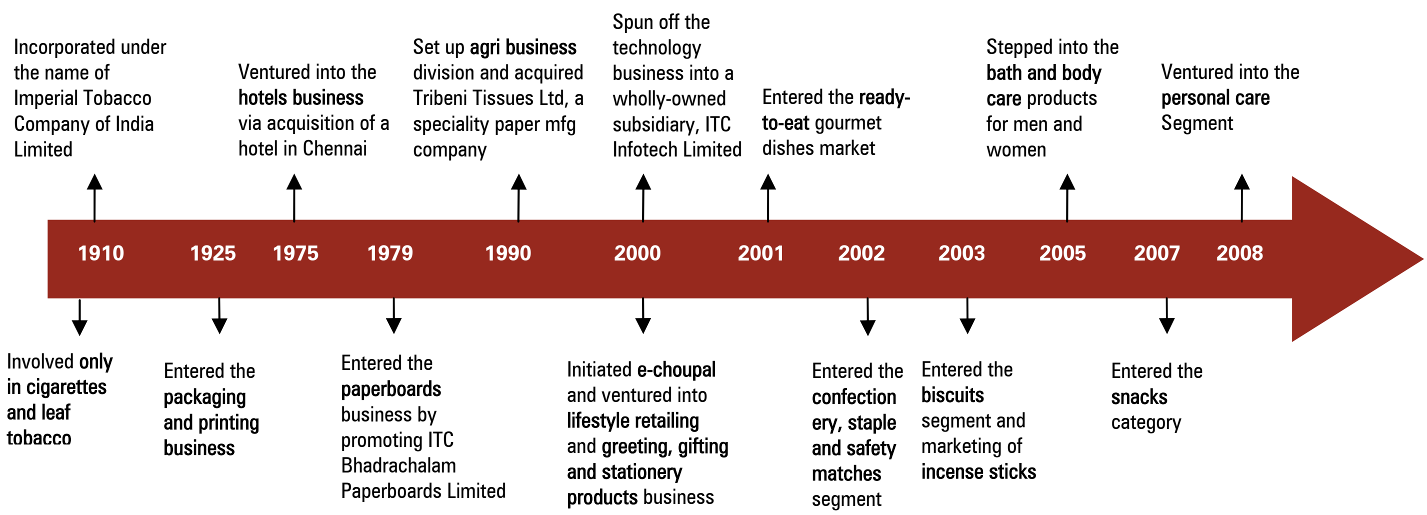
ITC, incorporated in 1910, is a professionally managed company with institutions holding 49.9% of shares, British American Tobacco (BAT) holding 31.2% of shares and public having 18.9% shareholding as in FY11.

Until 1925, ITC was only in the cigarettes and leaf tobacco business. From 1925 onwards, it diversified into various other businesses, paper (1925), hotels (1975), agriculture (1990) and FMCG (2000), capitalising on the opportunity in each segment. Entry into each business has also helped it to build a synergistic value chain for all its related businesses by providing forward and backward integration channels.

ITC has been the largest cigarette manufacturer and the market leader in the Indian cigarettes market. Occupying a dominant market position, ~75% by volume and ~83% by value in FY11, the company has no close competitor in the cigarettes space. In the paperboard segment, it is the second largest manufacturer in India with a capacity of 0.6 million tonnes (MT) and a value market share of ~26% in FY11. With a room capacity of ~7,000 rooms (owned and licensed) and presence across 90 locations, ITC is the second largest hotel chain in the country with high brand value both in the luxury and mid-market segment.

ITC's break through initiative for the agricultural industry, 'e-choupal', has helped the company to source ~40% of its agri-input needs in-house. By setting up ~6000 e-choupals in almost 3,800 villages, the company has built a strong distribution network for itself in rural India. ITC was a late entrant in the non-cigarette FMCG segment. Despite this, however, its strong distribution network, both in the urban and rural markets, have helped it to create strong brands in the packaged food (Aashirvaad & Sunfeast are ~₹ 1000 crore brands each) and personal care (Vivel and Superia) categories and garner substantial market share in each category within a short span of time.

Exhibit 2: Snapshot of ITC's business

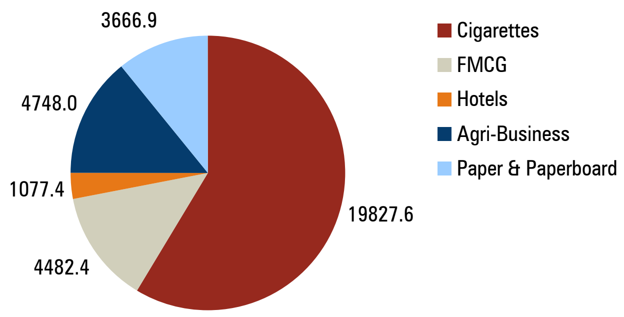


Source: Company, ICICIdirect.com Research

ITC's strong position across businesses has led its net revenues to grow at a CAGR of 14.9% from ₹ 12164.3 crore (FY07) to ₹ 21167.6 crore (FY11). Profitability for the same period grew at a CAGR of 16.6% from ₹ 2700 crore to ₹ 4987.6 crore led by the ability to sustain margins at ~33% over the years.

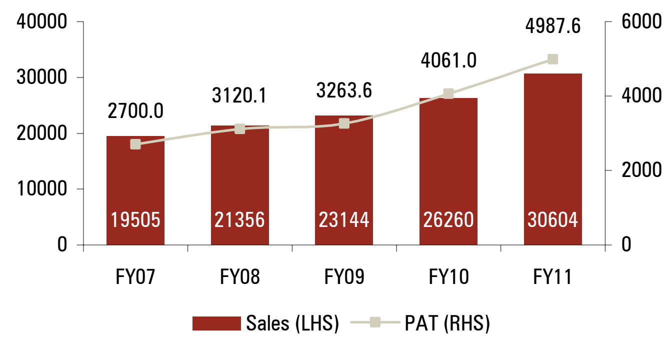
Though cigarettes continue to dominate ITC's topline, diversification has helped the company to reduce its dependence on cigarettes from 81.1% in FY04 to 58.7% in FY11. The contribution to gross revenues of the other businesses in FY11 stood at 14% from agri-business, 13.3% from FMCG, 10.8% from paper, paperboards & packaging and 3.2% from hotels.

Exhibit 3: Contribution of each business to revenues (FY11) (in ₹ crore)



Source: Company, ICICIdirect.com Research
Contribution is on Gross Revenues in FY11

Exhibit 4: Net revenues and PAT (FY07-11) (in ₹ crore)



Source: Company, ICICIdirect.com Research

Exhibit 5: Snapshot of the various businesses along with the brands and their relative market position

Category	Sub-category	Brands	Market Position
Cigarettes & FMCG	(A) Cigarettes	Wills, Gold Flake, Navy Cut, Capstan, India Kings	Market leader in cigarettes in India with 83% share by value & 75% share by volume
	(B) FMCG		
	(i) Branded packaged foods	Kitchens Of India, Sunfeast, Aashirvaad, Candyman, Bingo	Aashirvaad & Sunfeast are ~₹ 1000 crore brands
			Aashirvaad is the market leader with ~56% share among the national branded players
			Sunfeast has already garnered ~11% all India-urban market share
			Candyman is the market leader in the hard boiled confectionery segment
	(ii) Lifestyle retailing	Wills Lifestyle, John Players, Miss Players	Wills Lifestyle has a strong market standing in the top end branded apparel market
			Wills Lifestyle has 73 exclusive stores and more than 150 'shop-in-shop' presence
			John Players has ~280 flagship stores and 1100 multi brand outlets
	(iii) Personal care products	Essenza Di Wills, Fiama Di Wills, Vivel, Superia	Garnered a market share of ~5% in soaps and ~3.4% in shampoos by 2010; i.e within a span of 2 years
	(iv) Education and stationery products	Classmate, PaperKraft	Classmate continues to enjoy leadership position in the student notebooks market
	(v) Safety matches	Aim, i-Kno, Mangaldeep	
	(vi) Incense sticks	Mangaldeep	Mangaldeep is the second largest national brand
Hotels	(A) Luxury collection	ITC Hotels	ITC Royal Gardenia, Bangalore was recognized as the 'Best New Launch in the Luxury Upscale' category in FY2010
			All ITC Hotels have been awarded the LEED* Platinum Rating
	(B) 5-Star collection	Welcome Hotels, Sheraton	Co-branding agreements with Sheraton has made ITC-Welcom group the 2nd largest hotel chain in India
	(C) Mid market segment	Fortune	Established as a front-runner among the mid-market to upscale segment of hotels in India
	(D) Heritage leisure Segment	WelcomHeritage	The brand is India's most successful and largest chain of heritage hotels
Paperboards, paper & packaging	(A) Paperboards & speciality papers		Market leader in the paper board segment with a value market share of ~26%
			Largest cigarette-tissue manufacturer and leader with ~65% share of the domestic market
	(B) Packaging & printing		Leading supplier of value-added packaging to the consumer electronics and FMCG segment
Agri-business	(A) Cigarette leaf tobacco		Foremost supplier of quality Indian tobacco in the global market
	(B) Other agri commodities		Strategic sourcing support to the company's cigarette business
			Meets the agri sourcing requirements of the FMCG business to the extent of ~40%
			E-choupal initiative has been lauded as the most efficient agricultural supply chain for agri-products

**We have referred to the non-cigarettes FMCG business as 'FMCG' in our report. The company reports the results of this segment under the head FMCG (others)*

Source: Company, ICICIdirect.com Research

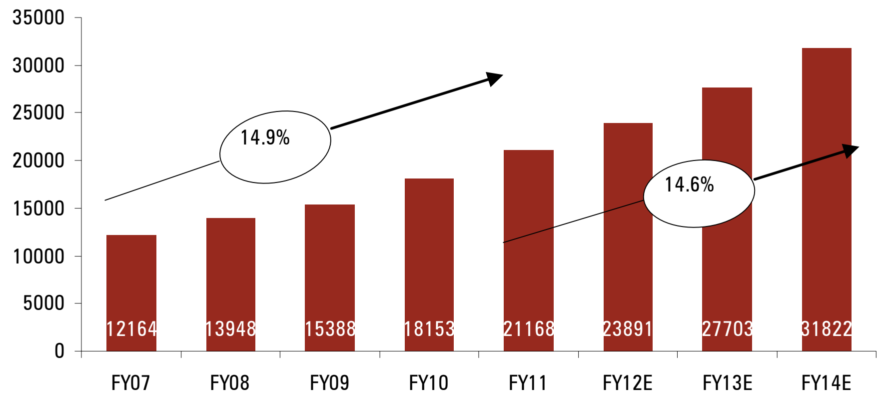
Investment Rationale

Market leader: Still hungry for growth

ITC is the largest cigarette manufacturer, a leading paperboard manufacturer and second largest hotel company in India. Buoyed by its dominance in cigarettes (83% market share by value and ~75% by volume), robust growth in FMCG (27.3% CAGR from FY07-FY11) and significant presence in hotels (with ~7000 rooms), the company's net revenues have grown at a CAGR of 14.9% from ₹ 12164.3 crore in FY07 to ₹ 21167.6 crore in FY11. Marked by its leading position across businesses, ITC's earnings growth has also remained robust at 16.6% CAGR in FY07-11 from ₹ 2700 crore to ₹ 4987.6 crore.

Sales have grown constantly over the years led by the growth scross all businesses.

Exhibit 6: Net sales (₹ crore) from FY07-FY14E

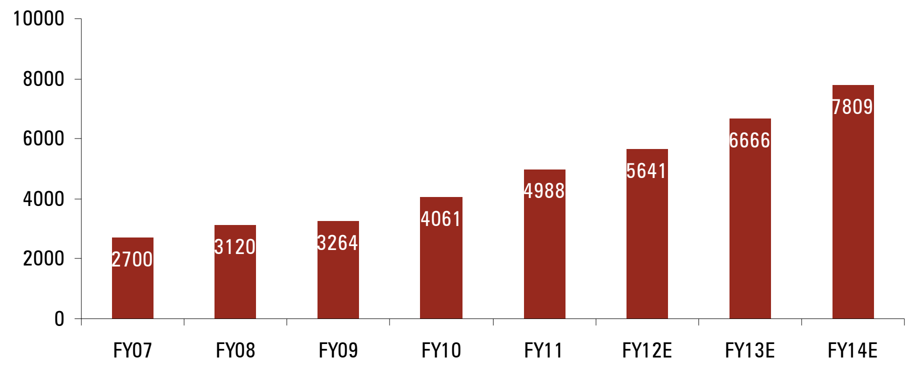


Source: Company, ICICIdirect.com Research

Going ahead, with the dominance in cigarettes remaining intact and revenues across other businesses continuing to witness healthy growth, we estimate ITC's net revenues will grow at a CAGR of 14.6% from FY11-14E while earnings growth will continue growing at a higher rate of 16.1% (CAGR FY11-14E).

ITC has maintained a CAGR growth of ~17% in its net profits and we expect the growth to be sustained led by its leadership in cigarettes industry.

Exhibit 7: Net profit trend(₹ crore)

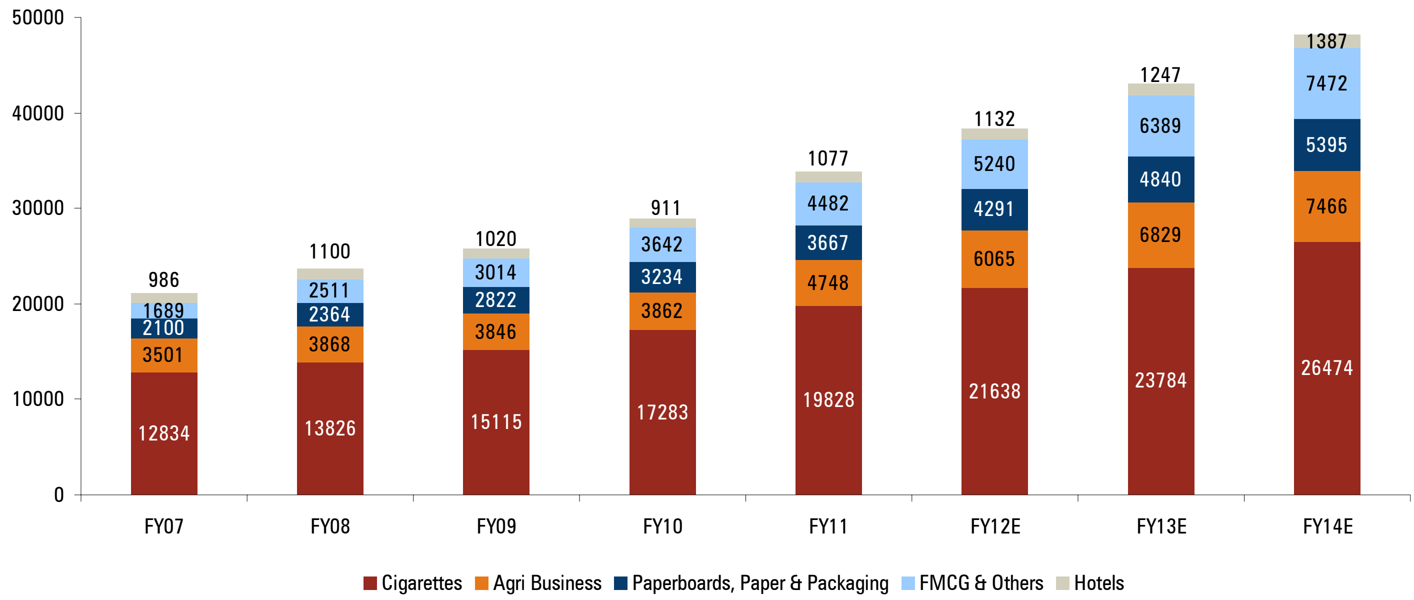


Source: Company, ICICIdirect.com Research

Revenue mix

ITC's gross revenues mainly consist of its mainstay cigarettes business that contributes 58.7% of revenues followed by the other businesses, agriculture, FMCG, paperboards and hotels, comprising 14%, 13.2%, 10.9% and 3.2%, respectively. With the company aggressively increasing its presence in other businesses, we expect this revenue mix to change by FY14E shifting the contribution of cigarettes to 54.9%, FMCG to 15.5%, agri-business to 15.5%, paperboards to 11.2% and hotels to 2.9%.

Exhibit 8: Revenue growth across businesses



Source: Company, ICICIdirect.com Research

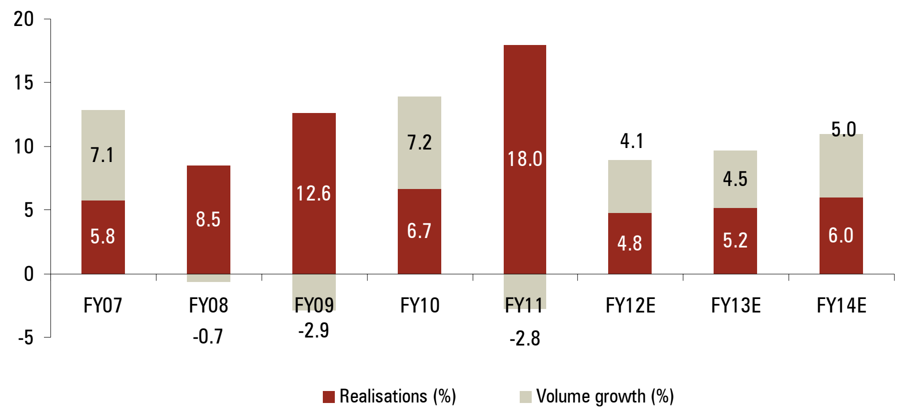
The change in revenue mix would be led by a higher revenue growth (CAGR FY11-14E) in FMCG, agri-business and paperboards at 18.6%, 16.3% and 13.7%, respectively. The growth (CAGR in FY11-14E) in cigarettes and hotels is expected to be relatively moderate at 10.1% and 8.8%, thereby reducing their contribution to overall gross revenues.

Dominance in cigarettes continues

ITC's cigarette business, with its extensive contribution of ~59% to gross revenues continues to provide the company a firm foundation for growth. The company has gained volume market share from 71% in 2004 to 75% in FY11 and maintained its leadership position. We expect the company's cigarette revenues to grow at moderate pace of 10.1% CAGR during FY11-14, which would be led by 4.5% volume and 5.3% price rise. Gross cigarette revenues have grown at a CAGR of 11.5% from ₹ 12,883.7 crore in FY07 to ₹ 19827.6 crore mainly backed by persistent price rise. However, volumes have remained flat during FY07-11 mainly due to its exit from the non-filter cigarettes business in FY08.

We expect a moderate revenue growth of 10.1% during FY11-14E led by 4.5% growth in volumes and 5.3% rise in prices

Exhibit 9: Volume and realisations growth

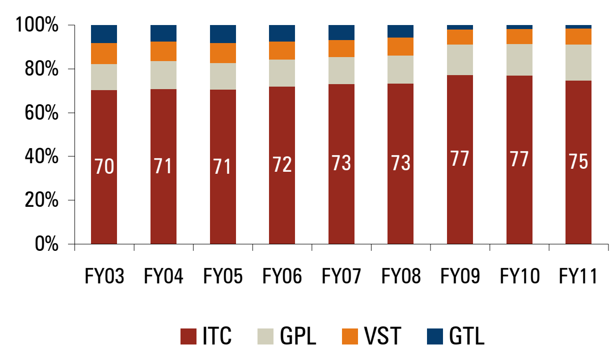


Source: Company, ICICIdirect.com Research

Largest market share

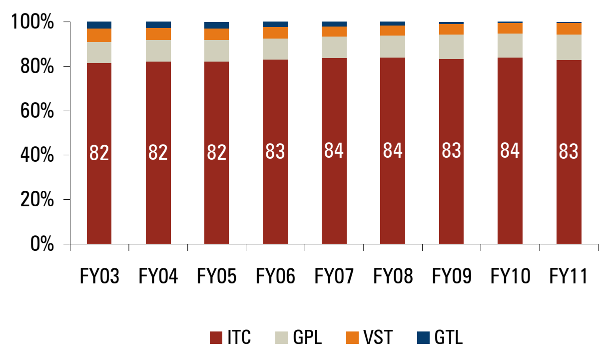
The Indian cigarettes market has four major players – ITC, Godfrey Philip, VST and Golden Tobacco Company. ITC has the largest market share both in volume (75% in FY11) and value terms (83% in FY11). After the Budget of 2008, most players have migrated from the non-filter to the filter category as non-filter cigarettes became unviable after the ~200% increase in excise duty. We believe all players are mainly concentrating on high-end filter cigarettes and ITC's large presence at the high end would help it to consolidate its dominance.

Exhibit 10: Market share by volumes (%)



Source: Capitaline, ICICIdirect.com Research

Exhibit 11: Market share by value (%)



Source: Capitaline, ICICIdirect.com Research

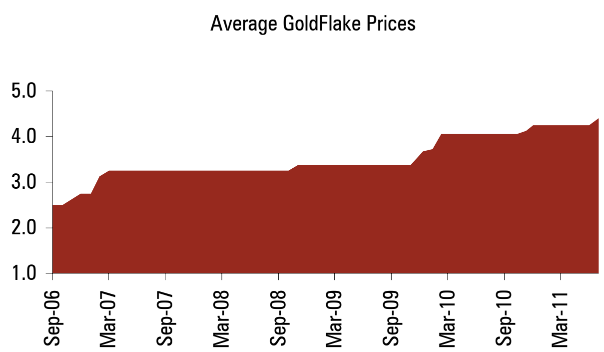
Strong brands at all price points

The biggest strength of ITC lies in its strong brands and its vast distribution network. Strong brands like Insignia, India Kings, Lucky Strike, Classic, Gold Flake, Navy Cut, Players, Scissors, Capstan, Berkeley, Bristol and Flake, Silk Cut, Duke and licensed brands like Benson & Hedges have helped the company to gain market share and hold on to its leadership position. It offers products in filter cigarettes at every price point from ₹ 2.8 to ₹ 8.0 per stick. ITC exited the non-filter segment in 2008.

Pricing power continues

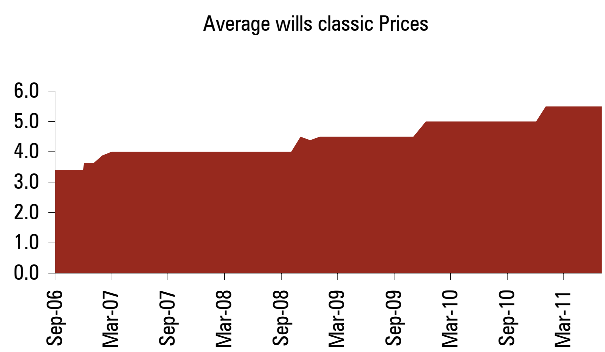
ITC's pricing power remained very strong. The company has passed on every excise duty/value added tax (VAT) increase through judicious price hikes. The company's topline growth in the last 10 years has mainly been through price led growth. In the last five years, Gold Flake (~43% of cigarette revenues in FY11) and Wills (~10% of cigarette revenues in FY11) have seen ~12% and ~10% CAGR price hikes. This has been much higher than CAGR 5.5% increase in excise duties. We have seen the company generally take price hikes before or around the Budget in anticipation of increase in excise duty. In 2011, ITC has taken ~5% hike in January and ~10% price hike in August. We believe ITC, being the market leader, would continue to command this pricing power as competitive pressures remain limited mainly to Marlboro, a Philip Morris Brand.

Exhibit 12: Average Gold Flake prices (₹ per stick)



Source: Company, ICICIdirect.com Research

Exhibit 13: Average Wills prices (₹ per stick)

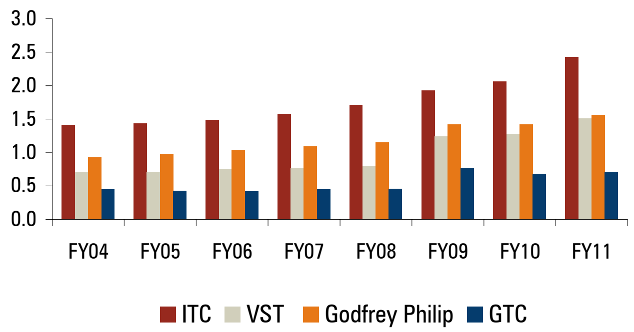


Source: Company, ICICIdirect.com Research

ITC commands a premium over competitors

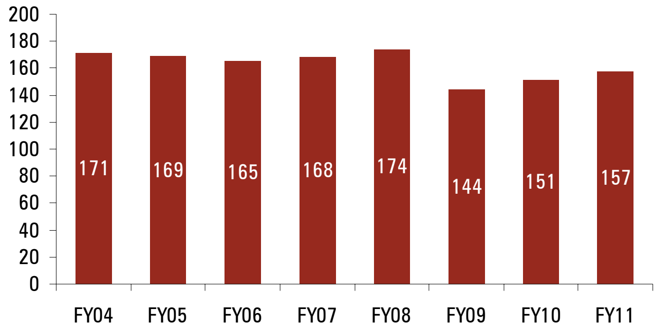
ITC's average cigarettes realisation is higher than its competitors. We have seen the company generally commands a premium of 1.5-1.6x in prices over its competitors like Godfrey and VST. Though competitive brands like *Marlboro* are giving tough competition to its *Wills Classic* brand, it has managed to gain only~2% market share. We believe there is no major competition to ITC's well established brands and these would continue to command realisation premium in future.

Exhibit 14: Per cigarette realisations (₹)



Source: Company, ICICIdirect.com Research

Exhibit 15: ITC realisation premium over Godfrey and VST (%)



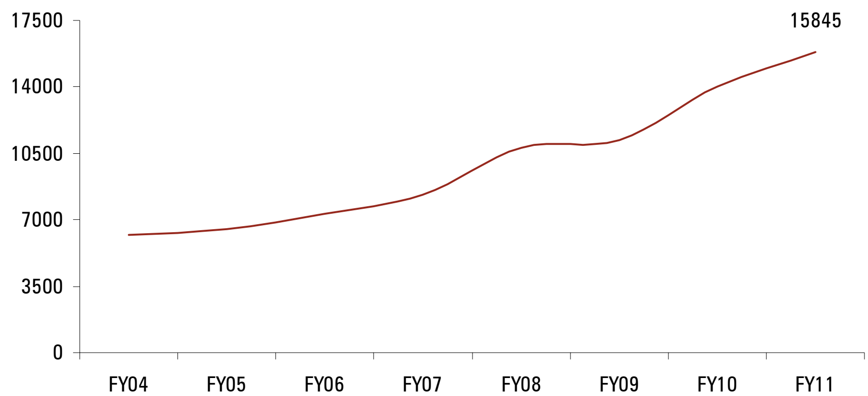
Source: Company, ICICIdirect.com Research

Increase in excise duty to remain moderate in future

We believe that over the years government's focus has largely been on curbing tobacco consumption. However, imposing higher duties on cigarettes is only curbing cigarette consumption with other forms of tobacco consumption left unchecked. Considering cigarettes are the least harmful among tobacco products, the government is now trying to shift its strategy to curtail consumption of other products through various methods such as, banning plastic packaging for tobacco products and banning the use of tobacco in food items. On the other hand, cigarettes are also a large contributor to the revenues of the Indian exchequer. Hence, we believe that the government would certainly not want to curb the demand for cigarettes. Therefore, going forward, we expect the increase in excise duties on cigarettes would be moderate and an increasing level of domestic income would shift the consumption from other tobacco products towards cigarettes.

ITC contributes ~1.7% of the total tax (direct and indirect collection of government of India

Exhibit 16: ITC's contribution to exchequer (₹ crore)



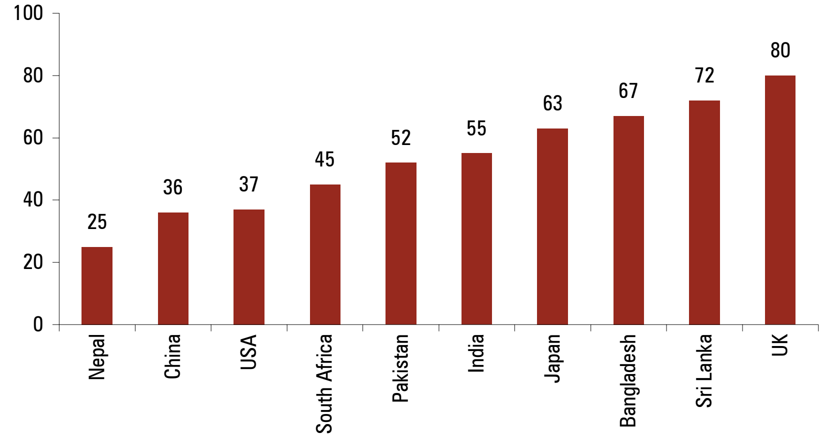
Source: Company, ICICIdirect.com Research

Lenient taxation to curb illicit trade

Taxes on cigarettes in India have stayed closer to the world average. However, in Nepal and China taxes are much lower resulting in illicit trade in India. We believe that a more lenient taxation policy on cigarettes in India could help to curb illicit trade from neighbouring countries.

Neighbouring countries like Nepal and China have lower taxes compared to India, which encourages illicit trade. We believe moderate taxes would curb these trades and would result in higher revenues for the exchequer

Exhibit 17: Taxes as a percentage of realisations (%)



Source: Company, ICICIdirect.com Research

Though tobacco products would come under the purview of Goods and Services Tax (GST), which advocates uniform duties across products, additional excise duties would be levied on tobacco products. We believe implementation of GST would bring some relief to cigarette manufacturers as it will bring down overall duties on tobacco.

Realisations cost and margin

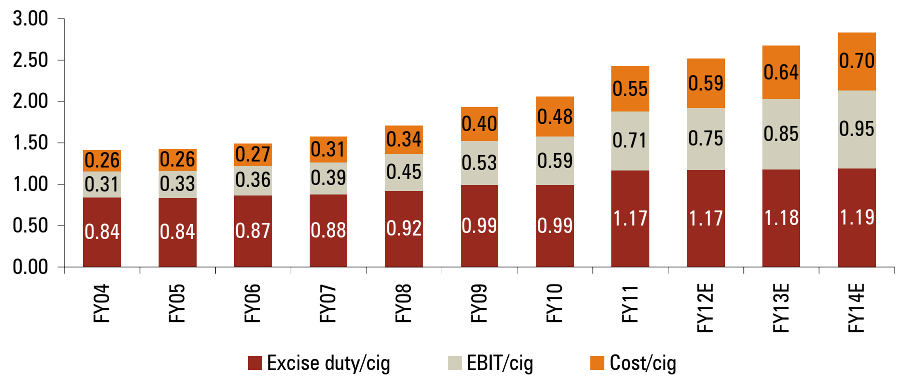
The company has maintained revenue growth with a mix of volume and price growth from FY04-11.

Over the years (FY04-FY11), ITC has taken aggressive price hikes whenever volume growth has remained muted. From FY04-07, ITC witnessed fairly strong volume growth of 7.5% with the price hike remaining moderate at 3.8%. On the flip side, from FY07-11, average realisations increased by 11.3% CAGR on account of aggressive price hikes with subdued volume growth. Therefore, we expect the company to continue with its strategy of judicious price hikes whenever there is low volume growth.

Thus, following the historical trend we expect the company to take prices hikes in-order to maintain revenue growth in cigarettes. We are expecting moderate price hikes of 4%, 6% and 6% in FY12E, FY13E and FY14E, respectively, on the back of no excise duty hikes in the FY11 Budget by the Government of India. Therefore, with the price hikes being reasonable, we expect the volume growth to be 4.5%, 4.5% and 5% in FY12E, FY13E and FY14E respectively.

EBIT per cigarette has risen from ₹ 0.31 in FY04 to ₹ 0.71 in FY11. We expected it to expand to ₹ 0.95 in FY14

Exhibit 18: Excise duty, cost and margins per cigarette (₹)



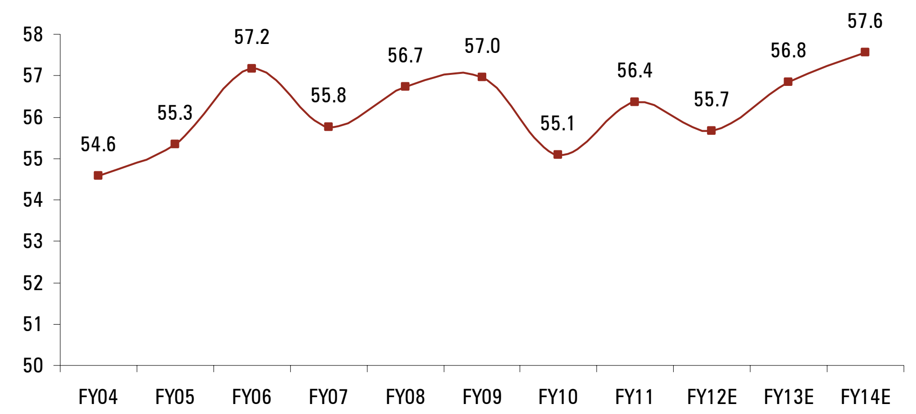
Source: Company, ICICIdirect.com Research

Cigarette margins to remain at elevated levels

Revenue growth has largely been driven by price increases. EBITDA margins for the segment have witnessed a continuous improvement. Margins in the segment improved from 54.6% in FY04 to 56.4% in FY11. We believe cigarettes margins would continue to rise in future on account of continuous price hikes. We expect an EBITDA margin of 55.7%, 56.8% and 57.2% in FY12, FY13 and FY14, respectively.

Cigarette margins would continue to grow on the back of judicious price hikes

Exhibit 19: Cigarette segment EBITDA margins (%)

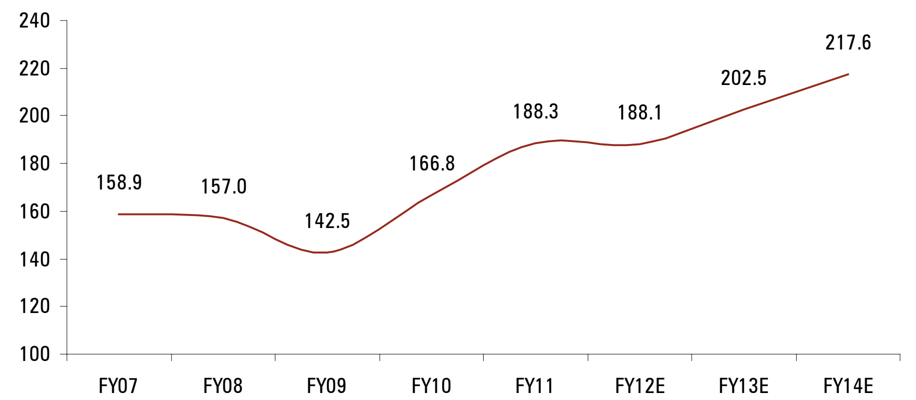


Source: Company, ICICIdirect.com Research

ITC's return on capital employed (RoCE) has improved from 158.9% in FY07 to188.3% in FY11 despite flat volumes. Going ahead, with the strong volume growth and sustained price hikes, we expect the cigarette business RoCE to increase to 217.6% by FY14E. Thus, we believe that an incremental capex of ~₹ 1000 crore (guided by the management) in the next three years could generate incremental EBITDA of ~₹ 3000 crore.

The company is likely to invest ~₹ 1000 crore in the next three years (FY12-14E). Thereby, we expect RoCEs from cigarettes to grow above 200%

Exhibit 20: Return on capital employed of cigarette segment (%)

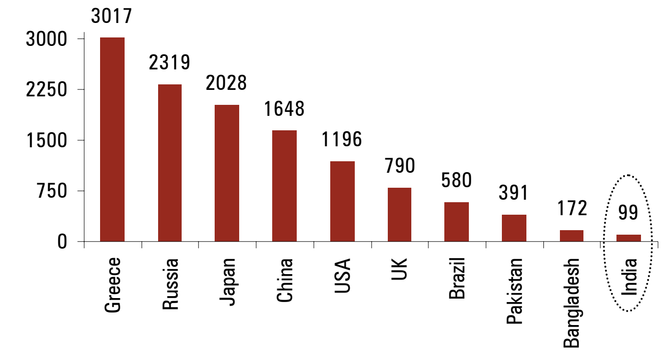


Source: Company, ICICIdirect.com Research

One of the lowest per capita consumption

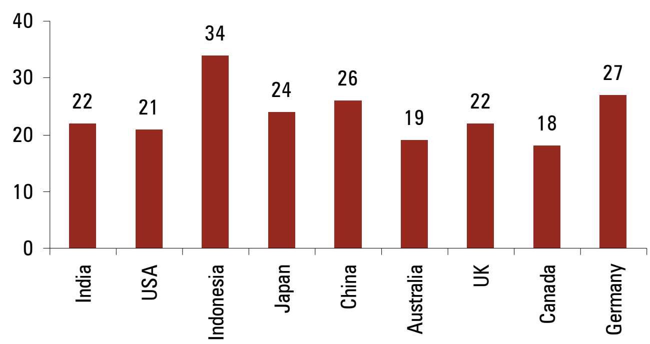
Despite India's tobacco consuming population being equivalent to the global average, per capita consumption in India is almost 1/12th of developed countries like the US and 1/8th of the UK, where most of the population consume tobacco in the form of cigarettes. India's per capita consumption of cigarettes (99) still remains incredibly low compared to developed countries like Greece (3017), Japan (2028), US (1196) and developing countries like China (1648) and Brazil (580). However, ~21% of the Indian population consumed tobacco. This discrepancy can be explained as only ~4% of the tobacco is consumed in India through cigarettes and the rest of the tobacco consumption is through other forms like bidis, khaini and chewing tobacco. Abysmally low taxation on bidis and comparatively high duties on cigarettes is also one of the prime reasons for demand not shifting to cigarettes.

Exhibit 21: Per capita consumption of cigarettes



Source: Various media reports,, ICICIdirect.com Research

Exhibit 22: Tobacco consuming population (%)



Source: Various media reports , ICICIdirect.com Research

In contrast to India, globally cigarettes have been the preferred way to consume tobacco. However, we believe that rising per capita income, high young population and increasing urbanisation in India would result not only in people shifting from bidis and chewing tobacco to cigarettes but also add new population to consume cigarettes. Hence, with only 4% of the Indian population consuming cigarettes, we expect the long-term average volume to grow at 4-5%.

Exhibit 23: Tobacco consuming populations in India (in crore)

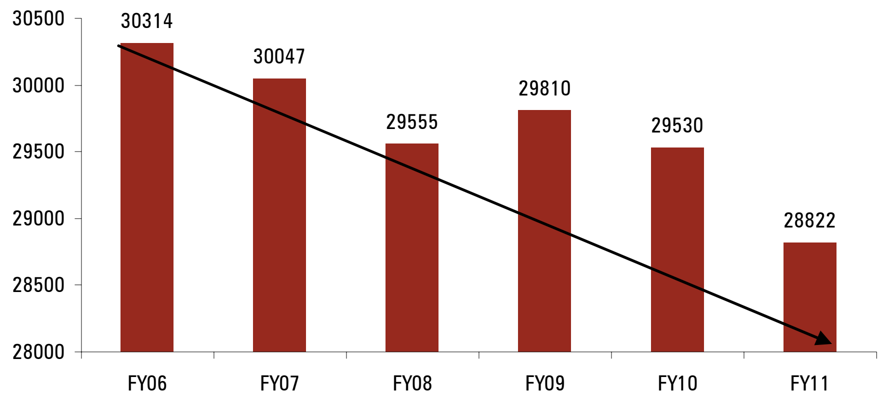
Total tobacco consuming population	27.5
Smokers of various smoking tobacco products	
Cigarettes	4.6
Bidi	7.3
Cigar, Cheroot or cigarillos	0.5
Hookah	0.7
Other smoking products	0.3
Total	11.1
Users of Smokeless tobacco	
Betal quid with tobacco (Pan)	5.0
Khiani / tobacco lime mixture	9.2
Gutka / tobacco lime, areca nut mixture	6.5
Oral tobacco use	3.7
Others smokless tobacco product	3.5
Total	20.6

Source: Global Adult tobacco survey India 2010, ICICIdirect.com Research

In the last six years, we have seen bidi production in India going down from 30,314 million sticks to 28,822 million sticks, which shows that cigarettes are slowly becoming a more preferred way of consuming tobacco compare to bidis.

Declining bidi production is a sign of demand shifting from bidis to cigarettes

Exhibit 24: Bidi production in India (in '000 numbers)



Source: CMIE, Industry Analysis, ICICIdirect.com Research

Long-term growth remains intact

In the last 15 years (FY1996-FY2011), ITC's cigarette volumes have grown at a CAGR of 2.0% and average price rise in cigarettes has been 8.9%. Thus, the company has maintained revenue growth of 11.1%, which is a 1.1x increase in per capita income during the same duration.

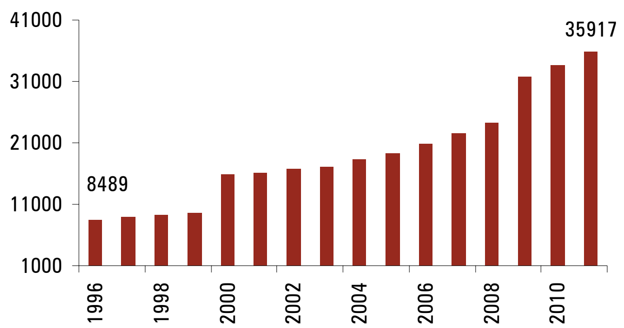
Considering the real GDP growth to be ~8% and average inflation to be around 5.6% in the next five years, India's per capita income is expected to grow at 11-12% during the same period. Historically, cigarette revenues have grown at 1.1x the per capita income of the country. Hence, we expect the cigarette industry to grow at 11-12% (1x the per capita income growth). ITC, being the leader in the industry, would grow around the estimated industry average. However, we have been conservative in our estimates by taking 10.1% cigarettes revenue growth for the next three years.

Exhibit 25: Growth in sales, volumes & prices in comparison to macro indicators (FY1996-2011)

Volume growth	2.0%
Price hike by ITC	8.9%
Sales growth	11.1%
India's per capita income	10.1%
Average inflation	5.6%

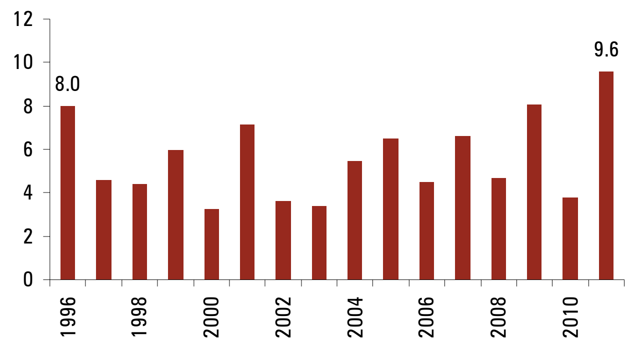
Source: RBI, Company, ICICIdirect.com Research

Exhibit 26: Per capita income of India (in ₹)



Source: RBI, Company, ICICIdirect.com Research

Exhibit 27: WPI inflation (%)



Source: RBI, Company, ICICIdirect.com Research

Regulatory norms over the last 10-15 years have created entry barriers for new players and, hence, benefited ITC

Regulations creating entry barriers: strengthening leadership

Regulations on the industry like increasing central and state excise duties, ban on advertisement, smoking at public places and mandatory pictorial warning on packets have been a deterrent to volume growth of cigarettes but have not affected the consumption of tobacco. However, advertisement ban and high taxes have resulted in high entry barriers and would restrict new entrants. This has curtailed the competition for ITC. With the ban on smoking in public places not being implemented strictly, tobacco consumption has not been affected largely. Cigarettes being a high revenue generator for the government, steps to curb cigarette smoking would only affect the exchequer. Hence, we believe the government would not enforce any steep increase in duties in future. Moreover, measures like ban on use of plastic in packaging of gutkha products and ban on use of tobacco in food products would adversely impact the consumption other tobacco products and be relatively favourable towards cigarettes.

Exhibit 28: Key Features of COPTA

Key features of COPTA
(i) Ban on smoking in public places, including indoor workplaces
(ii) Ban on direct and indirect advertising of tobacco products
(iii) Ban on sale of tobacco products to minors (less than 18 years of age)
(iv) Ban on sale of tobacco products within a radius of 100 yards of educational institutions
(v) Display of mandatory pictorial health warnings on all tobacco product packages
(vi) Testing of tobacco products for tar and nicotine

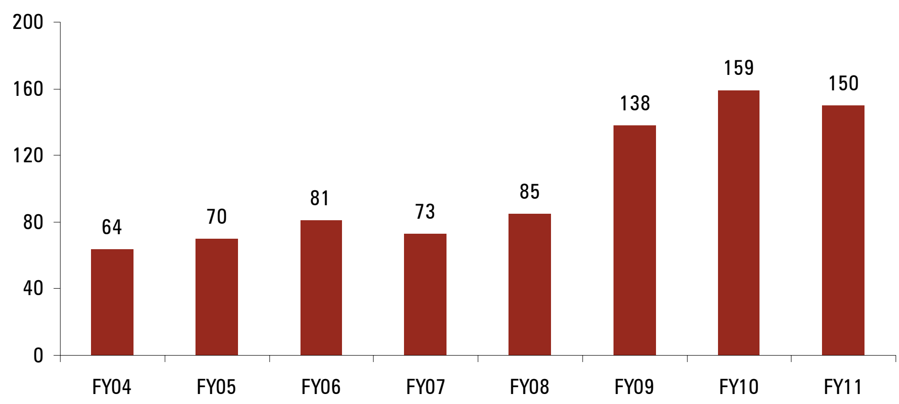
Source: Global Adult tobacco survey India 2010, ICICIdirect.com Research

Tobacco prices have risen at ~12% CAGR during FY04-11.

Raw tobacco

Cost of manufacturing cigarettes has been mere 20% of revenues and a major part of revenues is taxes. Though raw tobacco prices have increased 2.3x in the last seven years, changes in raw tobacco prices have a relatively less effect on cigarette prices compared to taxes and duties. Export realisations have shot up from ₹ 138 per kg in FY09 to ₹ 150 per kg in FY11. With raw tobacco cost being only ~25% of total cost, a ~10% increase in raw tobacco prices would result in only 2-3% increase in the overall cost. Therefore, we believe raw tobacco prices would continue to remain insignificant in determining prices or affecting cigarette demand in future.

Exhibit 29: Tobacco prices (₹ per kg)



Source: Tobacco Board of India, ICICIdirect.com Research

Gaining strength in FMCG business

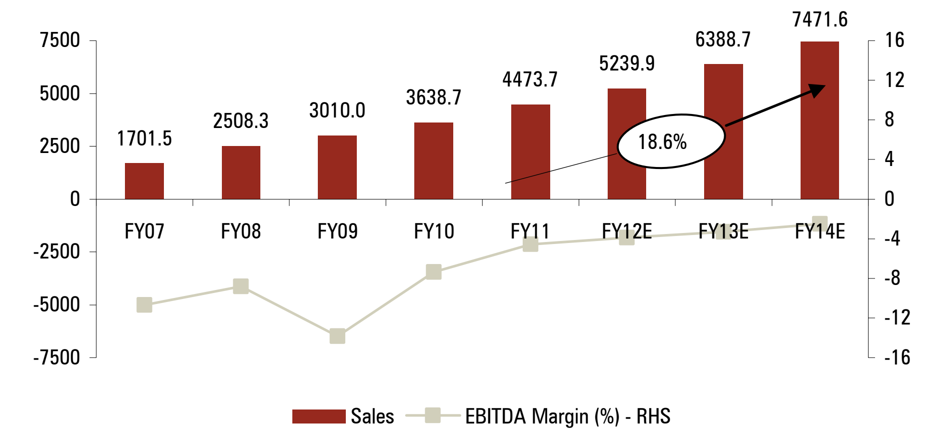
The matches and incense sticks businesses are a value-addition to the pulp, with stationery and greeting cards being the downstream verticals for paper and the agri-business and e-choupal initiatives aiding the foods business

ITC's FMCG revenues (gross) have grown phenomenally (almost 2.6x) over the past five years, from ₹ 1701.5 crore in FY07 to ₹ 4473.7 crore in FY11. This has been led by the company's aggressiveness in establishing itself in the segment and entry into a new category almost every year since FY01. Consequently, ITC has built powerful brands in the foods (Aashirvaad, Sunfeast, and Bingo) and personal care (Vivel, Superia) segment within a short span of its presence in the segment.

The entry into each segment has also been backed by the company's synergistic chain of related businesses that contributed to the FMCG value chain and provided it an edge in maintaining its margins compared to its peers. Therefore, losses (EBITDA level) from the segment declined from 10.7% in FY07 to 4.6% in FY11. Going ahead, we expect FMCG revenues to grow at a CAGR of 18.6% (FY11-14E) and the segment to achieve breakeven (EBITDA level) only after FY14E. We believe the future growth would be aided by the strong demographics of the country and the company's ability to gain a substantial presence in the segment.

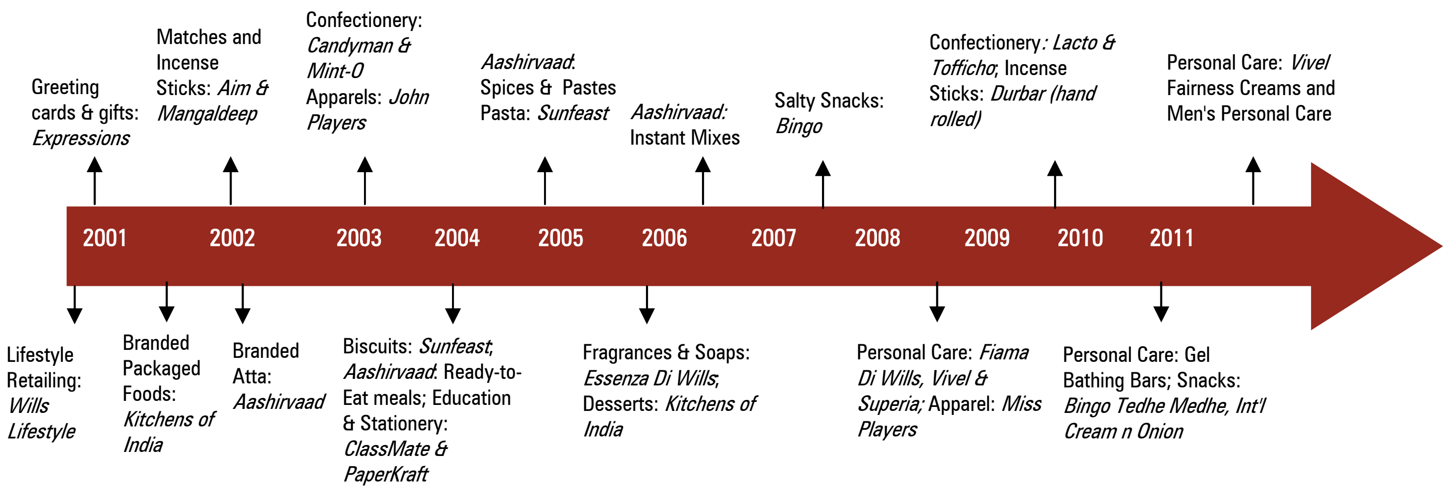
Revenues have grown at a CAGR of 27.3% (FY07-FY11) with the contribution to gross revenues increasing from 8% in FY07 to 13.3% in FY11

Exhibit 30: Sales (₹ Crore) and EBITDA margins of FMCG to gross revenues



Source: Company, ICICIdirect.com Research

Exhibit 31: Evolution of ITC's FMCG business

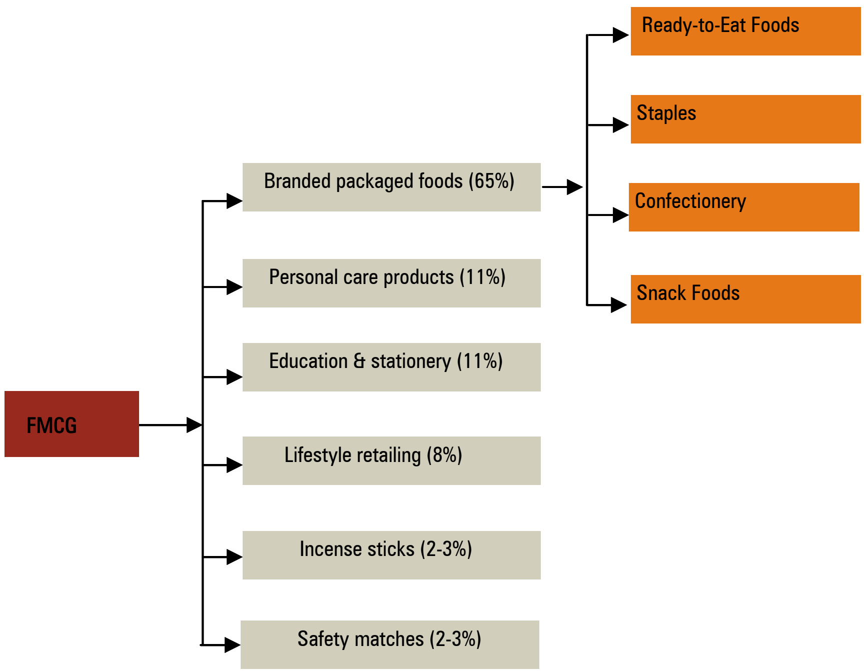


*Years refer to Financial year ending

Source: Company, ICICIdirect.com Research

ITC's FMCG portfolio is segmented into the branded packaged foods (ready-to-eat, staples, confectionery, and snack foods), personal care, education and stationery, lifestyle retailing and matches and incense sticks category. The contribution of each in the segment's gross revenues (₹ 4473.7 crore for FY11) is estimated to be 65%, 11%, 11%, 8% and 5%, respectively.

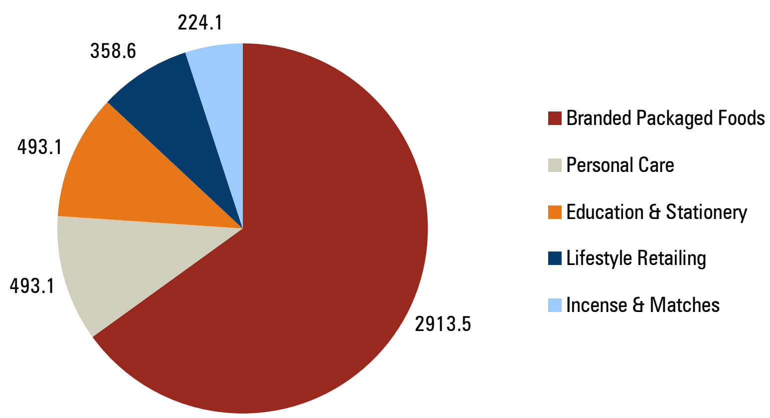
Exhibit 32: Segmentation of FMCG business



Source: Company, ICICIdirect.com Research

Branded packaged foods is the largest category contributing almost 2/3 to FMCG (others) revenues as in FY11

Exhibit 33: Estimated sub-category sales for FMCG portfolio (FY11) in ₹ crore



Source: Company, ICICIdirect.com Research

With ITC's capability to build strong brands in the segment in which it ventures, it has successfully built leadership positions in the branded staples, confectionery and education and stationery markets with the respective brands, Aashirvaad (56% market share of the organised branded *atta* category), Candyman (market leader in the boiled confectionery segment) and Classmate (~12% market share in the notebook segment). In the other FMCG categories also, ITC has been successful in garnering a significant share of the market within a few years of its entry into the segment. The other biggest and fastest growing brands of ITC are Sunfeast (~ ₹ 1000 crore brands with offerings of biscuits, pasta and noodles), Vivel (soaps and fairness cream) and Bingo (snack food).

The performance of the other brands and the respective offerings are illustrated in the table below: (Exhibit: 35)

Exhibit 34: FMCG Business – A snapshot of the company's brands & the respective offerings

Category	Brands	Entered	Remarks	Competitors
(A) Branded Packaged Foods		Q2FY02		
(i) Ready to Eat Foods	Kitchens of India	Q2FY02	Largest in the Ready-to-Eat segment, Achieved break-even in FY11, Sales is ~₹30 crore (exports being ~3x domestic sales)	MTR Foods, ADF Foods
(ii) Staples	Aashirvaad	Q1FY03	Mkt leader with ~56% share in organised branded flour market The brand has also ventured into packaged salts and enjoys ~10% market share Further extended it to spices	Packaged Flour - Annapurna (HUL), ShaktiBhog, Pillsbury Salt - Tata Chemicals (30% mkt share) Spices - MDH, Ashok, Everest
(iii) Confectionery	Mint-O	Q4FY02	Market leader in the hard boiled segment	Perfetti, Parle, Cadburys
	Candyman	Q1FY03		
(iv) Snack Foods	Sunfeast	Q2FY04	~₹1000 crore brand, Largest brand in FMCG Portfolio, Market share ~10% (Urban India) Ventured into instant noodles (Dec, 2010) & pasta category in FY10	Biscuits - Parle, Britannia Noodles - Nestle (Maggi), Nissin (Top Ramen)
	Bingo	Q4FY07	Mkt share is estimated at ~10-12% of the ₹3000 crore snacks market	Frito Lays (mkt leader with ~60% mkt share), Parle
(B) Personal Care Products	Essenza-Di-Wills	Q3FY06	Premium Offerings with bath & body care products	
	Fiama-Di-Wills	FY08	Premium Products offering shampoos, conditioners, soaps & shower gels	
	Superia	FY08	Soaps & Shampoos aimed to target at value consumer Brand Size is ~₹200 crore	Soaps - Godrej, HUL
	Vivel	FY08	Bath care & skin cream products in mid-mkt segment with the brand size being ~₹200 crore Mkt share of ~6% in mid segment soaps; ~3.4%% in shampoos and 1.6% mkt share in bath & shower in FY11(0.9% in 2008) Extended into the fairness skin cream market and men's personal grooming market in FY11	Lux (80 year old brand) has 13.7% share in the bath & shower category
© Education & Stationery Products	Paper Kraft (Premium)	FY03	Estimated sales from the category ~₹280 crore (FY10) from ₹20 crore in FY05	
	Classmate (Popular)	FY04	Since 2007 onwards, Classmate is the leader in students notebooks segment; Has ~12% mkt share (FY10) in writing material segment (~₹4000 crore)	Navneet (organized market) and unorganized players (~75% of the ₹4000 crore notebook market)
(D) Lifestyle Retailing	Wills Lifestyle	FY01	Targeted at the premium end consumers Has 73 exclusive stores & ~150 shop-in-shops	Raymond, VanHeusen, Arrow, Color Plus
	John Players & Miss Players	FY04	Target consumers are the mid-market segment John Players has ~280 flagship stores & 1100 multi brand outlets and departmental stores	
(E) Incense Sticks	Mangaldeep	FY03	2nd largest national brand	Cycle Brand (Market leader)
(F) Safety Matches	Aim, I-Kno, Stylites	FY03	Leverages the core strengths of ITC in distribution, supply chain management and paper & paper boards business	

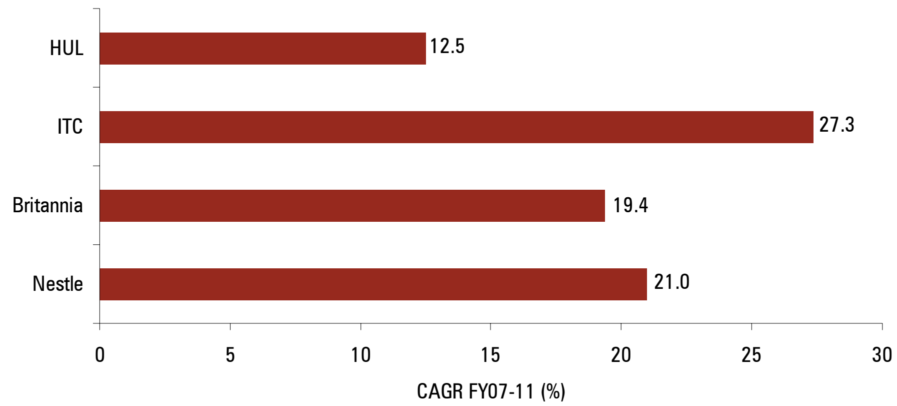
Source: Company, ICICIdirect.com Research

Fighting fit among FMCG peers

ITC's capability to build strong brands and its vast distribution network has helped it to match its growth with its peers.

In spite of being a late entrant in the FMCG space, the company's FMCG revenue growth has outpaced the growth of other industry players aided by its strong distribution network as well as the ability to build strong brands. ITC's FMCG revenues grew at a CAGR of 27.3% from FY07-11 compared to the revenue growth of Nestle and Britannia at 21% and 19.4%, respectively, and HUL's (personal care revenues) revenue growth remaining lower at 12.5%.

Exhibit 35: Growth in sales in past three years (CAGR growth from FY08-FY11)



Source: Company, ICICIdirect.com Research

We believe ITC's healthy growth has also been aided by a slew of new launches and entry into new categories over the years. In FY11, ITC had one of the highest numbers of launches (~10 new products) in the FMCG space, matched only by its closest competitor HUL. Moreover, over the years, ITC has ramped up its advertisement spends occupying the third position among the highest FMCG advertisers, moving up from the 7th position in FY08.

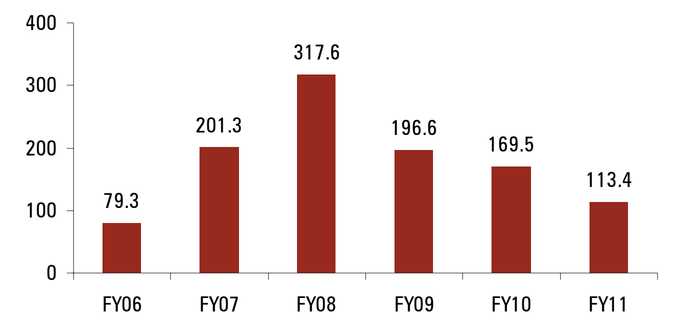
Planned capex that helped to build strong brands

In the FMCG space, capex requirements are largely deployed for building brands and a strong distribution network. With ITC already having an established distribution network for its cigarette business, we believe the higher capex in FY07 and FY08 would have been incurred for the aggressive launch of its largest snack brand, Bingo, and three of its personal care brands, Fiama Di Wills, Vivel and Superia.

Going ahead, ITC plans to incur capex of ₹ 500 crore (FY12-FY14) to strengthen its FMCG portfolio along with entry into new categories within foods and personal care. Further, the company has a couple of new launches lined up in FY12E for the personal care segment where it is aggressive to gain footprint. We believe this resilience is backed by the strong growth prospects of the segment (size of the personal care segment in India was estimated to be ₹ 30,000 crore as in FY10) along with the higher profitability that it offers.

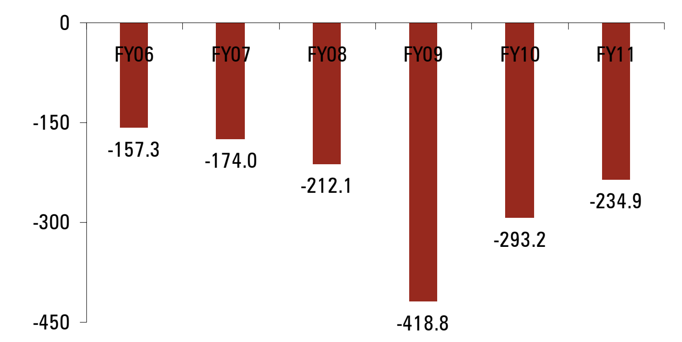
Moreover, with FMCG losses declining and brands achieving break-even at a faster pace than expected, we believe this business would consequently become self–sustainable in meeting its capex requirements by FY15E.

Exhibit 36: Capex trend (₹ Crore)



Source: Company, ICICIdirect.com Research

Exhibit 37: EBITDA trend (₹ Crore)



Source: Company, ICICIdirect.com Research

Strong position in paperboards, paper and packaging industry

Industry Outlook

The Indian paper and paperboard (P&PB) industry is classified under four broad categories: industrial paper, writing and printing (W&P) paper, newsprint paper and specialty paper, each comprising approximately 49%, 32%, 15% and 4% of the total demand (2009-10), respectively. Though India is the second largest populous country in the world (17% of world population), its share in paper consumption stands at only 3% of the global paper production. Moreover, the domestic per capita consumption of paper stands at only 8-9 kg compared to the world average of ~55 kg. Accordingly, this huge gap in domestic consumption is expected to be fulfilled by the increasing demand for branded products, organised retailing, differentiated packaging and increasing education rate. Thereby, the P&PB industry demand is estimated to grow at 8.1% CAGR (2010-11 to 2015-16) from 8.7 MT to 12.8 MT. (Source: Crisil Research).

Speciality paper demand is expected to witness the maximum growth (CAGR 2010-11 to 2015-16) of 9.3% followed by the paperboards demand growing at 8.1%

Exhibit 38: Demand outlook for each variety of paper

Type of Paper	End User Segment	Current Demand	Future Demand	CAGR (2010-11 to 2015-16E)
Paperboard	FMCG, Pharma, Garments Consumer Durables	5 mt	7.4 mt	8.1
Writing & Printing	Education Office Printing Advertisement & Publicity Magazines	3.3 mt	4.9 mt	7.9
Speciality Paper	Cigarettes Construction Electricity	0.4 mt	0.6 mt	9.3

**mt=million tonnes*

Source: CRISIL Research, ICICIdirect.com Research

The total capacity of P&PB is expected to increase from current 11 MT to 15 MT by 2015-16

With the demand for industrial paperboards and W&P paper set to witness robust growth, industry players are keenly ramping up their capacity. The total domestic capacity is, thereby, expected to increase from ~11 MT in 2010-11 to ~15 MT by 2015-16. The Indian P&PB industry is highly fragmented with the top 5 producers accounting for ~20-23% of the total domestic paper capacity (10.9 MT). Also, with the P&PB industry being highly capital intensive and having a long gestation period (two to three years), we believe it is the large players who would be the main beneficiaries of this upcoming demand.

Exhibit 39: Operational and market position details of top 3 players of the Industry

Company	Capacity (tonnes)	Production (tonnes)	Utilization (%)	Sales (tonnes)	Sales Mix	Market Position
Ballarpur Industries	836538	646590	77.3	201518	89% - W&P paper 11% - Speciality paper	Market leader in W& P Has ~24% share in the copier segment Has ~39% share in the coated paper segment Largest player in the industry
JK Paper	240000	273755	114.1	265045	71% - W&P paper 29% in Paperboards 0.3% -Speciality paper	Leader in the copier segment (share of 28.8%) 3rd in the coated paper segment 2nd in the duplex board segment
ITC	558648	621738	111.3	455716	60% - Industrial paper 23% - W&P paper 17% - Speciality paper	Market leader in the paper boards industry Market leader in duplex board (33% share) Second largest player in the industry

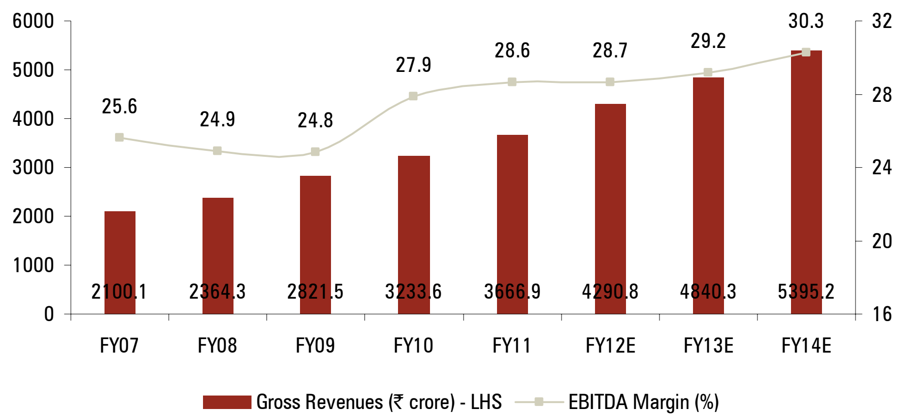
Source: CRISIL Research, ICICIdirect.com Research

ITC's P&PB revenue outlook

ITC's P&PB revenues (contributing ~10% to revenues) grew at a CAGR of 15.1% from FY07-11 led by 8% volume growth and 6.5% growth in prices. Going ahead, we expect revenues to grow at a CAGR of 13.7% (FY11-14E) to ₹ 5395.2 crore by FY14E led largely by volume growth (7.7%). We believe that growth in revenues would be supported by the company's leadership position (26% share by value FY11) in the paperboards industry (size 2.3 MT FY09-10) and strong position in the specialty paper industry (size ~4 lakh tonnes). Also, the benefit of forward integration with the company's cigarettes, FMCG and education and stationery products business would fuel the revenue growth.

Increasing capacity by ~0.1 MT and consolidating its ppresence in the high profitability speciality paper segment would drive ITC's P&PB revenue and earnings growth

Exhibit 40: Revenue and EBITDA margin growth from FY07-FY14E



Source: Company, ICICIdirect.com Research

On the margins front, we expect ITC's margins from P&PB to improve from FY12E onwards aided by increase in realisations (4.8% CAGR FY11-14E) and softening of raw material prices (pulp and wood). The increase in realisations would be driven by rising demand and insufficient capacity to match this. Also, with ITC's leadership position in the high-end cigarette paper market and significant share in the writing paper market, we believe the company's realisations would be higher than its industry peers.

With the outlook for this business being attractive, ITC with a substantial share of the organised market (second largest in the industry) and the business yielding double digit margins over the years, the company is planning to ramp up its existing capacity of ~0.6 MT to ~0.7 MT by

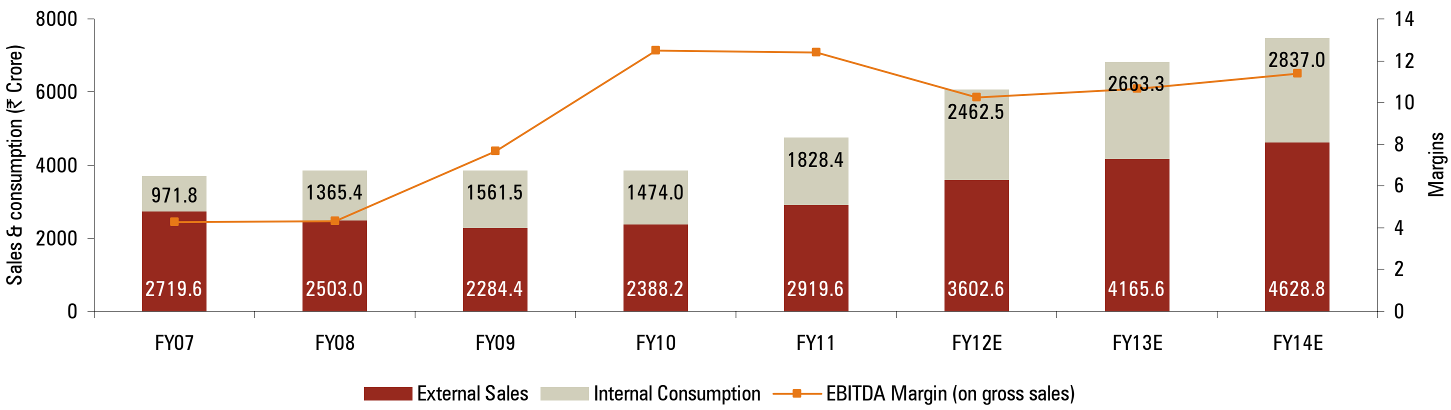
FY14E involving a capital expenditure of ~₹1000 crore (according to the management).

Consolidation in agri-business provides robust growth outlook

ITC's agri-business (~15% of total revenues) division is one of the country's largest exporters and traders of unmanufactured tobacco, soya, coffee, marine products (prawns and shrimps), processed fruits and spices. Apart from trading, the underlying key of ITC's expansion into this business is to align its commodity portfolio with the sourcing needs of its cigarettes, food and paper business. Currently, ITC's complete leaf tobacco requirement and ~40% of agri-product requirement is met internally.

ITC's agri-business revenues (including inter-segment and excluding rice) have grown at a CAGR of 12.1% from ₹ 4160.6 crore in FY07 to ₹ 6576.4 crore in FY11. Going ahead, we expect revenues to increase at a faster pace of 16.1% (CAGR FY11-14E) and clock revenues of ₹ 10302.9 crore by FY14E driven by the changing revenue mix. Also, the change in revenue mix has helped the margins to improve from 4.3% (FY07) to 12.4% (FY11), which we expect to get trimmed slightly to 10-11% by FY14E.

Exhibit 41: Agri-business sales & margins trend



Source: Company, ICICIdirect.com Research

ITC's external agri-revenue mix largely consists of leaf tobacco (~43% in FY11) and soya (~24% in FY11) sales. However, the revenue from coffee (~10% in FY11) and other agri and marine products (spices, fruit pulp, prawns and shrimps) has also witnessed an increase in revenue share over the years (~23% in FY11).

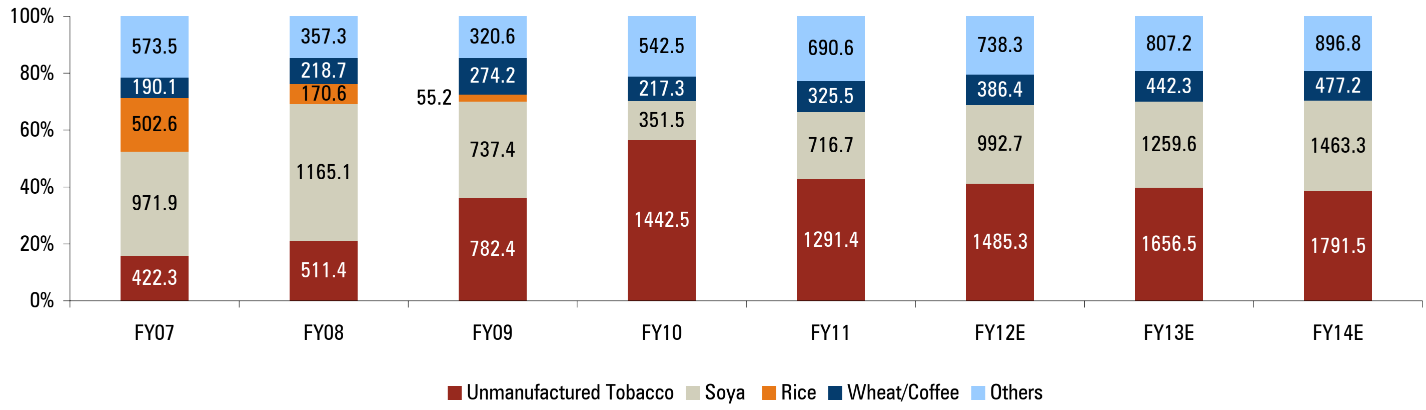
Going ahead, we believe the demand for leaf tobacco would remain benign on the back of tempered global cigarette production and higher crop sizes in the key tobacco growing countries (Brazil, Zimbabwe, Malawi and European Union). However, high export demand from Western Europe and South East Asia would result in strong margins from unmanufactured tobacco, which would also set off rising cost for the cigarettes business. Hence, we expect the leaf tobacco sales to grow at ~12% CAGR (FY11-14E) and its contribution in agri-business revenues to decline to ~38% by FY14E.

Among other agri-products, we expect soya sales to drive the company's agri-revenues led by anticipated decline in global soya bean production and rising demand for Indian soya bean and soya meal in the international markets. Hence, we expect soya sales to increase at a CAGR of ~27%

(FY11-14E) and its contribution in agri-revenues to increase to ~32% from ~24% in FY11.

Moreover, with spices export from India growing at 16% (FY11) and demand for coffee and fruit pulp also witnessing a higher demand, we remain positive on the sales growth of these commodities also and expect their contribution in agri-revenues to increase from current levels.

Exhibit 42: Composition of agri-business revenues to ITC (external sales) in ₹ crore



Source: Company, ICICIdirect.com Research

Soya includes sales of soya extraction, soya oil and soya seeds. ITC exited the trading of wheat from FY08 onwards; Others include marine products, fruit pulp etc

Increasing capacity to drive growth in hotel revenues

ITC is the second largest hotel chain in India, after Indian Hotels, catering to different categories through diverse brands. Its total room inventory currently stands at ~7,000 (~3,000 under owned properties and ~4,000 under management contracts) along with a strong chain of well known restaurants nationwide, having powerful cuisine brands.

ITC's hotel revenues (standalone) grew at a subdued rate of 2.2% from FY07-FY11, with margins also witnessing a decline from ~42% (FY07-FY08) to ~33% (FY09-FY11). The growth was muted due to various macroeconomic events such as terrorist attacks, swine flu pandemic and general slowdown of the economy in FY09 and H1FY10, thereby impacting foreign tourist arrivals and corporate travel growth.

Going ahead, we expect the growth to be higher at 8.8% (CAGR for FY11-14E) driven by increasing average revenue per room (ARR) and stable occupancy rate at ~65% (excluding new additions). Also, we expect Tier 1 cities to have higher revenue per available room (RevPAR) that would help ITC to sustain margins at current levels of ~33% (FY11-14E).

Premium hotel segment constitutes ~60% of ITC's total hotel revenues

The Indian premium hotel market size is ~₹ 11,230 crore and has grown at a CAGR of ~14% (FY06-11)

Exhibit 43: ITC's hotels segmentation

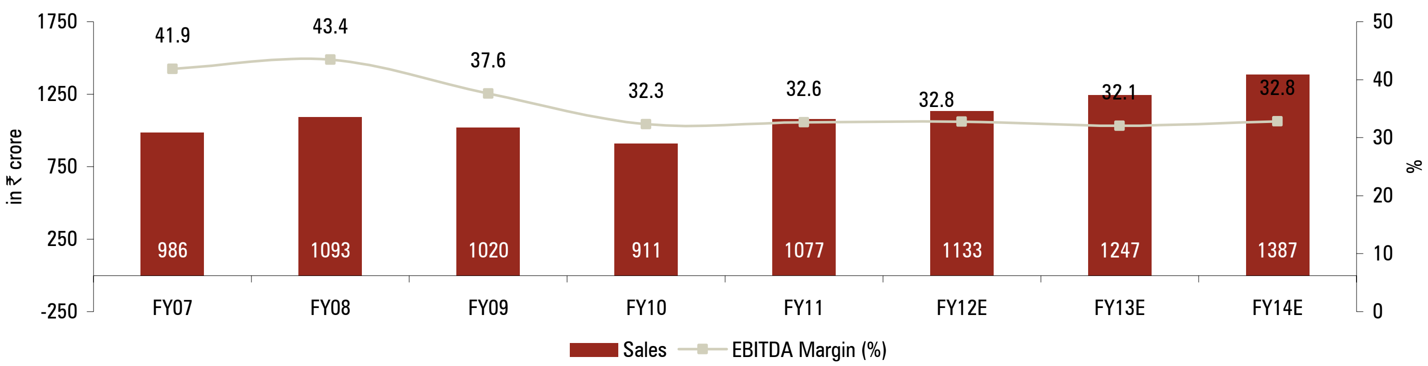
Segment	Brand	No. of rooms	Ownership/Arrangement
Luxury	ITC Hotels	~2400	Owned & Franchisee
5 Star	Welcome Group-Sheraton	~1100	Licensed & Franchised
Mid market	Fortune	~2400	Management Contracts
Heritage Leisure	Welcome Heritage	~1300	50:50 JV with Jodhana Heritage Resorts Pvt. Ltd.

*Licensing and Franchising agreements are with Starwod Group for its two international brands, 'The Luxury Collection' and 'Sheraton'

Cuisine	Restaurants
Indian Cuisine	Bukhara, Dakshin, DumPukht

Source: Company, ICICIdirect.com Research

Exhibit 44: Sales (₹ crore) & EBITDA margins (FY07-14E) trend



Source: Company, ICICIdirect.com Research

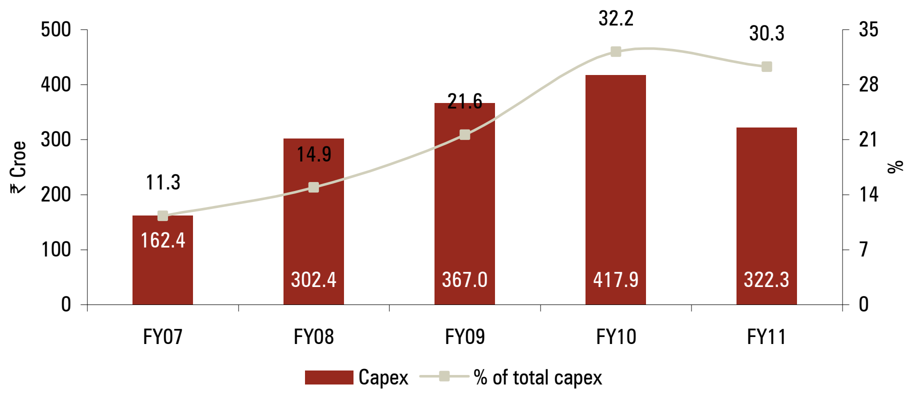
Upcoming hotels in luxury segment

Name of the hotel	Location	No. of Rooms	Estimated time of commencement
ITC Grand Chola	Chennai	600	End of FY12
ITC Hotel Resort	Manesar, Gurgaon	104	End of FY13
ITC Hotel	Kolkata	490	End of FY14

Increasing room capacity to employ huge capital expenditure

Revenues from the hotel business contribute only 3.2% to the company's gross revenues (FY11). However, it is one of the largest (~30%) capex guzzlers for the company. With three upcoming properties in the luxury segment (~60% of ITC's hotel revenues) its capex requirement for the segment is expected to reign higher until FY14E. According to the management, the capex in hotels by FY14E would be ~₹ 1500 crore.

Exhibit 45: Capex in hotels (₹ crore) and capex in hotels as a % of total capex of ITC



Source: Company, ICICIdirect.com Research

ITC also plans to expand its presence in the mid-segment hotels (brand: Fortune Hotels) by increasing the number of alliances. In FY12E, the company plans to open Fortune hotels in Kolkata, Chennai and New Delhi with capacity of 68, 108 and 34 rooms, respectively. It would further expand in Mysore, Manesar and New Delhi with capacity of 108, 50 and 21 rooms, respectively, by FY13E. Consequently, we estimate the room inventory for the overall hotel segment will increase to ~8,000 in FY13E and ~8,200 in FY14E from ~7000 rooms currently (FY11).

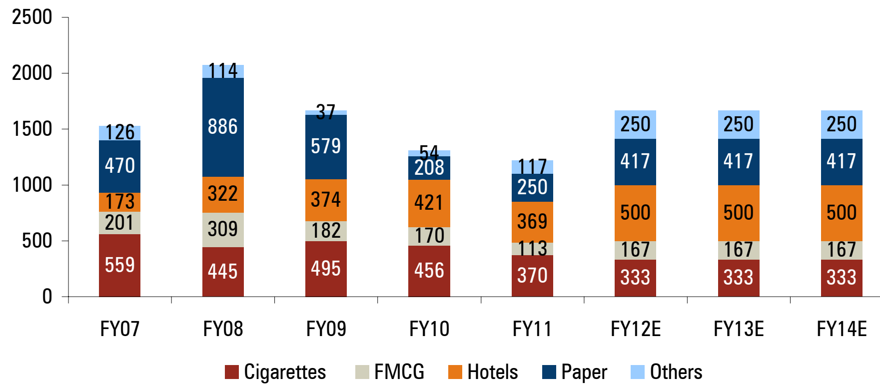
Therefore, we believe the revenue growth for the hotels business would largely be driven by volume growth, with the growth in average revenue per room (ARR) being marginal at ~1% per annum until FY14E. Further, with occupancy rates expected to be under pressure until FY15E, we expect the revenue per available room (RevPAR) to witness only a marginal increase in Tier I cities with Tier II cities witnessing a marginal downtrend.

Aggressive capex in hotels and paper business

Over the last five years, ITC's major capacity expansion has been in hotels, paperboard and cigarettes. Cigarettes capacity has increased from 107 billion sticks in FY07 to 142 billion sticks in FY11. Considering cigarettes capacity utilisation at 48%, we believe the company is not going to take up major capex in the cigarettes segment in the next three or four years. The company is going to take up major capex in the hotels segment during FY11-14 and increase room capacity by ~1100 rooms. Out of ₹ 5000 crore capex in FY12-FY14, the company is going to invest ₹ 1500 crore in the hotels segment, ₹ 1000 crore in cigarettes, ₹ 1250 crore in paperboard and ₹ 750 crore in the FMCG segment.

The company is increasing its capacity of 1,100 rooms in the hotels segment, which would entail ~30% of the total planned capex of ₹ 5000 crore (FY12-14E) by the company.

Exhibit 46: Segment wise capital expenditure (₹ crore)



Source: Company, ICICIdirect.com Research

Strong distribution network helps in tapping rural markets

With a vast distribution network due to its high cigarettes division penetration and vast rural presence (38,000 villages) through ~6,000 e-choupals, the company is utilising this network for the distribution of new launches in the FMCG segment. We believe the company would be able to benefit from increasing rural income levels, which would help it to tap the lower penetrated rural markets.

Risks and concerns

Regulatory issues for cigarette business

From time to time, the government has been putting restrictions on the industry to curb the use of tobacco products. In 2003, the government brought the Cigarettes and Other Tobacco Products Act (Cotpa), which restricts smoking at the pubic places and bans the advertisement of tobacco products. However, lately the government's emphasis has been on controlling the use of other tobacco products like ban on plastic packaging. It is even considering a total ban on other tobacco products. We believe these restrictions are unlikely to impact ITC's revenue streams as it has largely been price led.

Sharp increase in excise duties deterrent for volume growth

We have seen sharp hikes in excise duty being a deterrent in volume growth of cigarettes. During FY03-06 and FY10, there was no change in excise duty of filter cigarettes, which resulted into subsequent 7%+ volume growth during FY05-07 and FY10. Similarly, a steep increase in excise duties in FY07-09 resulted in flat volume growth during this period. We believe a similar trend would continue in future also. In the 2011 Budget, the government has kept the excise duty similar to the previous year. This would result in moderate volume growth in FY12. We have assumed 4.5% volume growth in the segment during FY12-14.

The sharp increase (~200%) in excise duties on non-filter cigarettes in the FY10 Budget has resulted in the exit from this segment by all companies as it made it unviable for manufacturers to sell non-filter cigarettes.

Exhibit 47: Excise duty on non-filter cigarettes (₹ per 1000 cigarettes)

Non Filter	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Micros <60	135	135	135	150	158	167	819	819	669
Plain 61-70	450	450	450	495	520	551	1323	1323	1475
Small Filter									669

Source: Ministry of Finance, ICICIdirect.com Research

We believe a similar sharp increase in the excise duty on filter cigarettes could be a deterrent to its volume growth, thereby impacting ITC's volume growth in future.

Exhibit 48: Excise duty on filter cigarettes (₹ per 1000 cigarettes)

Filter	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Less than or equal to 70 mm	670	670	670	740	780	819	819	969	969
71 to 75 mm	1090	1090	1090	1200	1260	1323	1323	1473	1473
76 to 85 mm	1450	1450	1450	1595	1675	1759	1759	1959	1959
Greater than 85mm	1780	1780	1780	1960	2060	2163	2163	2363	2363

Source: Ministry of Finance, ICICIdirect.com Research

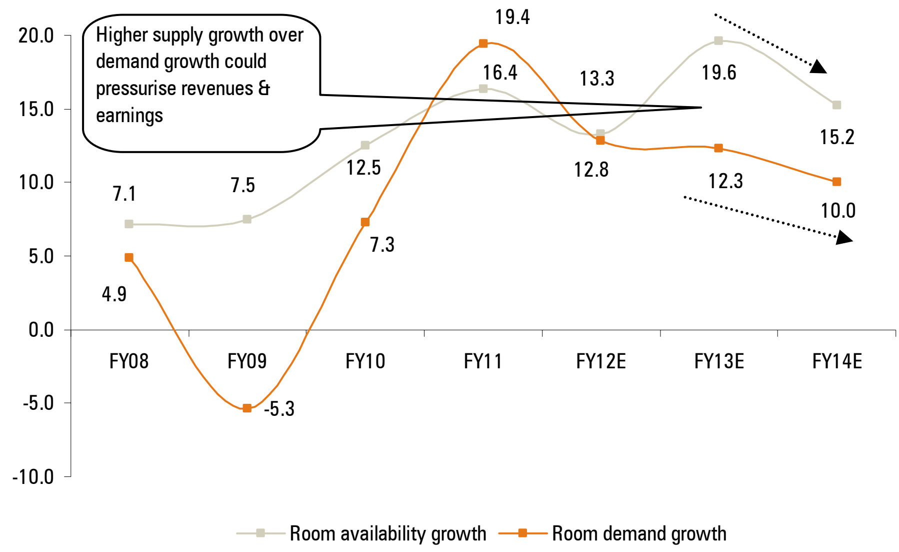
FMCG yet to break even

ITC's FMCG business is yet to achieve break–even. All its brands under the foods business (except noodles) achieved break even only in FY11, with the personal care business continuing to weigh heavy on the margins. Going ahead, with increasing competition across categories, especially in snacks, biscuits, ready to eat goods and personal care, we remain cautious on the FMCG margins growth and do not expect the company to achieve breakeven before FY14E.

Hotel industry slowdown may keep hotels earnings growth under pressure

The Indian premium hotels market (₹ 11,300 crore market size) witnessed a subdued CAGR of 4.3% from FY08-FY11 on the back of higher rooms availability compared to demand and a series of unfavourable world events. Consequently, the occupancy rates also fell from ~72% (FY08) to ~62% (FY11) and RevPAR witnessed a decline from an average of ₹ 6948 (FY08) to ₹ 4948 (FY11). Going ahead, with the environment continuing to remain grim as the room availability is expected to be higher than the demand and a slowdown in the world economy leading to a fall in the expected tourist arrivals in the country, we are wary of the growth in hotel revenues.

Exhibit 49: Hotel room availability and room demand growth (FY08-14E)



Source: CRISIL Research, ICICIdirect.com Research

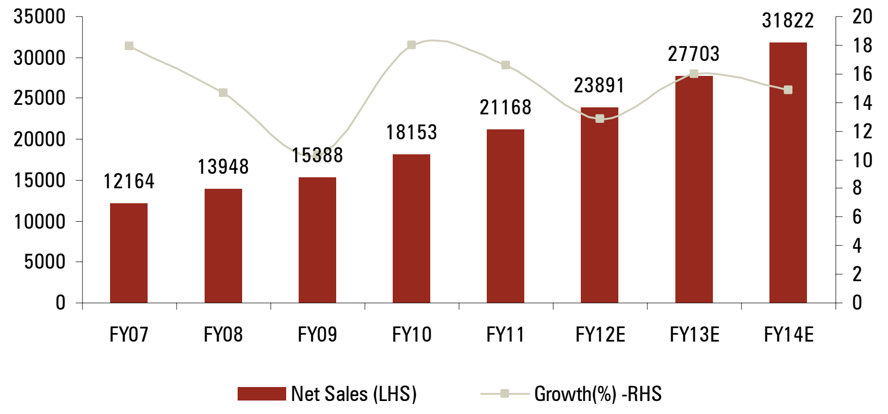
Financials

Strong revenue growth

Revenues are expected to grow at a CAGR of 14.6% to ₹ 31822.1 crore by FY14E led by sustained growth in cigarettes and other segments

ITC's net revenue growth from FY07-11 stood at 14.9% to ₹ 21167.6 crore in FY11 led by sustained growth in cigarettes, FMCG and P&PB businesses. We believe the cigarette segment would continue to grow at a moderate pace (10.1%) led by decent volume growth and judicious price hikes. Simultaneously, the FMCG business will grow at a strong CAGR of 18.6% to ₹ 7471.6 crore (FY14E) led by strong growth in packaged food. However, we believe the hotels revenue growth to be modest at 8.8% by FY14E due to a slowdown in the economy. We expect the paperboard business (including inter segment) to grow at a CAGR of 13.7% to ₹ 5395.2 crore in FY14E led by 7.7% volume growth and 4.8% price hikes. Hence, we expect the overall business (net revenues) to grow at a CAGR of 14.6% to ₹ 31822.1 crore in FY14E.

Exhibit 50: Revenue and revenue growth



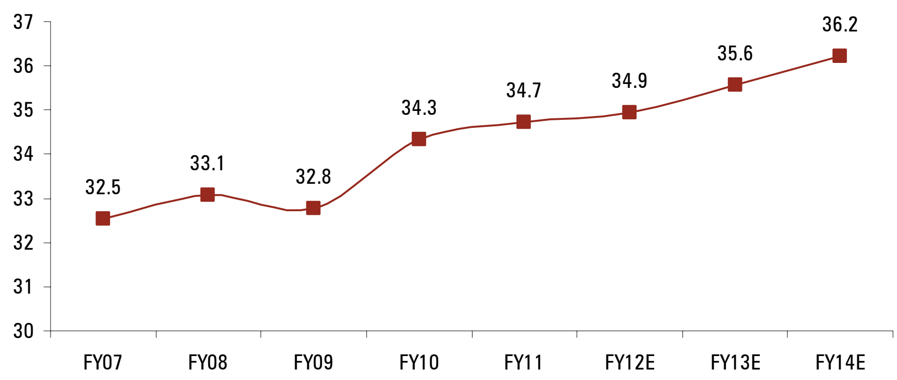
Source: Company, ICICIdirect.com Research

Margins to improve further

EBITDA margins would increase to 36.2% by FY14E led by improving EBITDA from cigarettes and P&PB, sustained margins in hotels and agri-business and reducing losses in the FMCG business.

ITC's EBTDA margins have grown from 32.5% in FY07 to 34.7% in FY11 led by consistent prices hikes in cigarettes. Increase in excise duty has been an added opportunity for ITC to take price hike in cigarettes and helped it to improve margins. Going ahead, we expect margins in FY12E and FY13E to increase as the company has taken two price hikes already (January,2011 and August,2010) despite no excise duty hikes. We expect margins to improve to 36.2% by FY14E.

Exhibit 51: EBITDA margin trend (%)

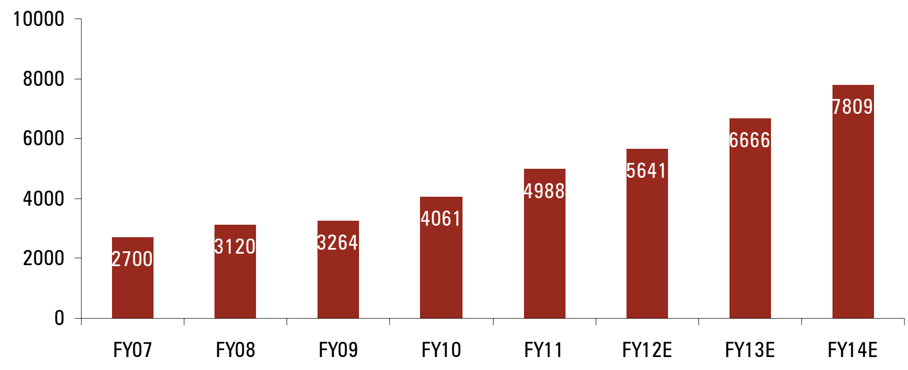


Source: Company, ICICIdirect.com Research

Net profit growth to remain high

The company's net profit has grown at a CAGR of 16.6% (FY07-11) to ₹ 4987.6 crore in FY11 mainly led by increasing revenues, higher EBITDA and other income. Other income has grown at a CAGR of 11.4% from FY07-11 due to the higher earnings from current investments. We expect the net profit to grow at a CAGR of 16.1% (FY11-14E) to ₹ 7,808.7 crore by FY14E.

Exhibit 52: Net profit (₹ crore)



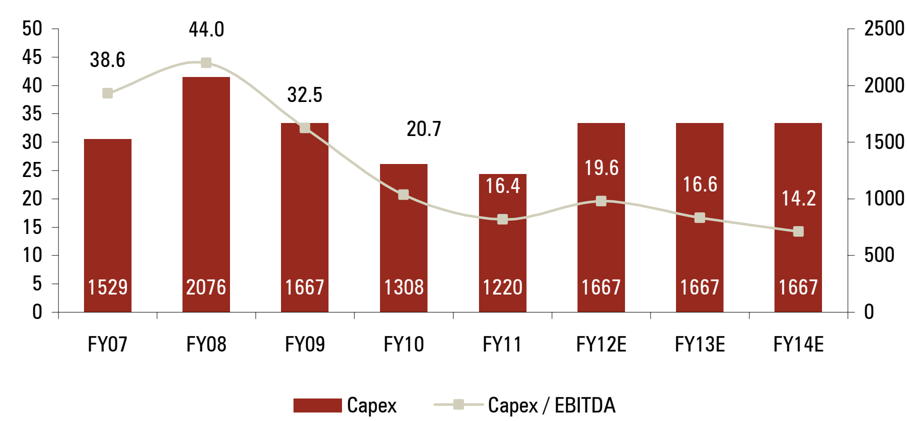
Source: Company, ICICIdirect.com Research

Capex to EBITDA

We expect the company's average capex per year to remain at ~₹ 1650 crore (FY12-14E), similar to the average capex of ₹ 1600 crore per year in last five years (FY07-11). Out of the total estimated capex of ₹ 5000 crore from FY12-14E, the major chunk of ~30% or ~₹ 1500 crore will be in the hotels segment. Capex of ~₹1000 crore (FY12-14E) could be there in the P&PB business in order to expand capcity by ~0.1 mt. The capex requirement in FMCG business has witnessed a decline from ₹ 300 crore in FY08 to ₹ 113 crore in FY11, which we expect to remain at current levels. Further, considering that the company is utilizing only 48% of its capacity (FY11) in cigarettes, we do not expect any major addition to be taken up there. Hence, with an increasing EBITDA and lower capex, we expect capex to EBITDA ratio to come down from ~39% FY07 in to ~20% in FY12E and 14% in FY14E.

Capex to EBITDA will decline from 38.6% in FY07 to ~15% in FY14E due to lower requirement of capex across businesses.

Exhibit 53: Capex (₹ crore) Capex to EBITDA (%)



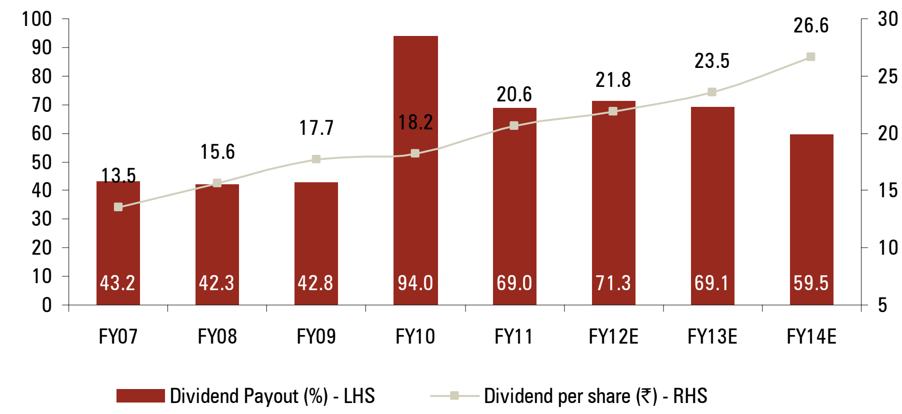
Source: Company, ICICIdirect.com Research

Dividend payout to increase

With the capex/EBITDA ratio coming down, the company's dividend payments have risen from ~42% in FY07 ~68% in FY11. The company paid ~94% dividend in FY10, which includes one-time centenary dividend. Considering, lower requirement for capex, we expect the dividend payout to increase to ~70%, going forward.

Average dividend yield is expected to increase to ~2.6% by FY14E.

Exhibit 54: Dividend payout and dividend per share



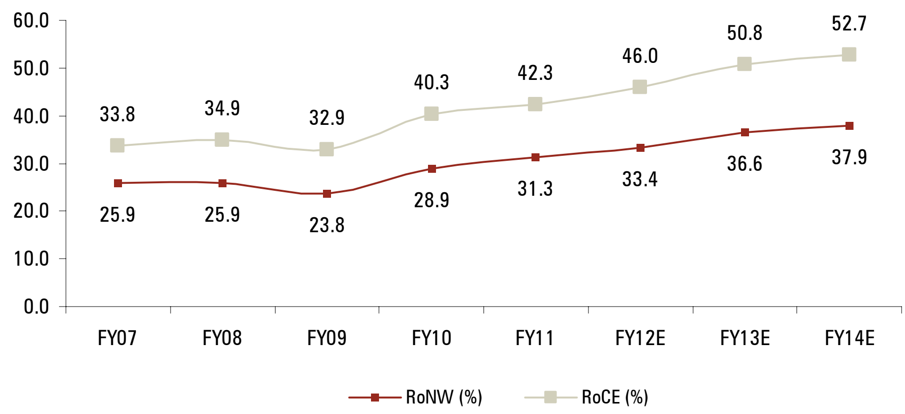
Source: Company, ICICIdirect.com Research

Attractive return ratios

ITC's RoE has increased from ~26% in FY07 to ~31% in FY11 led by a higher dividend payout. We believe return on equity will further increase to ~38% by FY14E led by higher earnings growth and increasing dividend payment. Return on capital employed has grown from ~34% in FY07 to ~42% in FY11 and is expected to increase to ~53% in FY14E.

Return rations will improve as dividend payout increases to 80%

Exhibit 55: Attractive return rations (%)

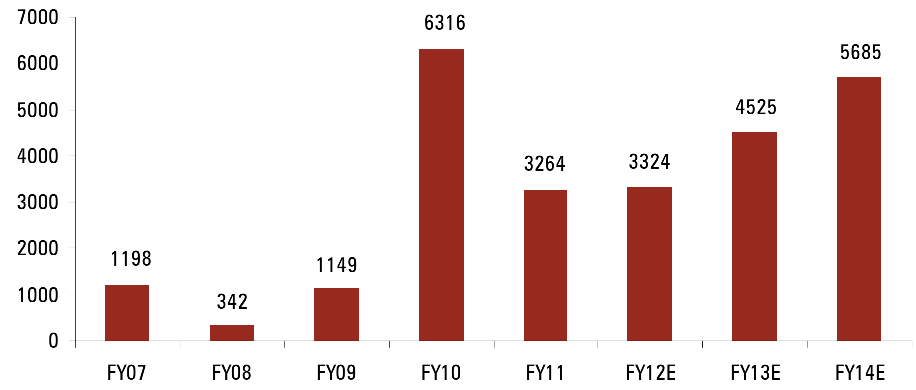


Source: Company, ICICIdirect.com Research

Free cash to fund capex

Considering higher EBITDA and lower capex requirements, we expect ITC's free cash flow to increase from ~₹ 3300 crore in FY11 to ~₹ 5700 crore by FY14E. During FY07-09, free cash flow remained low (in the range of ~₹ 300-1200 crore) due to higher capex requirement of the company. The company cut down its capex requirement in FY10-11 and paid higher dividend. Going forward, supported by higher revenues and EBITDA, we expect the company to generate ₹ 3000-5000 crore of free cash after meeting its regular capex requirement of ₹ 1600 crore.

Exhibit 56: Free cash flows (₹ crore)

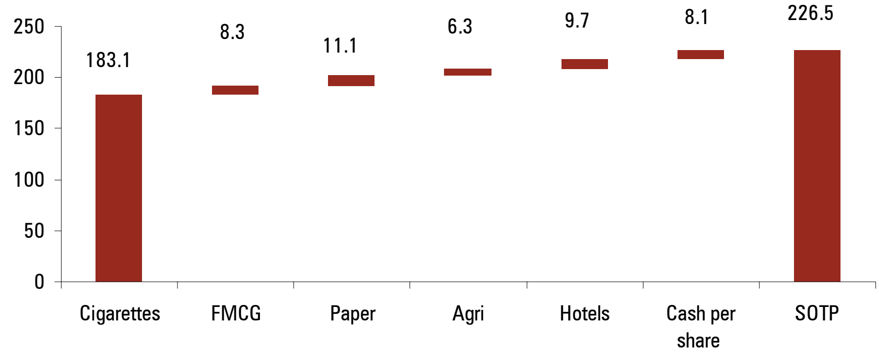


Source: Company, ICICIdirect.com Research

Valuation

We have valued ITC on the basis of sum of the part (SOTP) valuation. Our fair value for the stock comes to ₹ 226.5 per share. With the cigarettes business contributing almost ~59% to revenues and ~77% to EBITDA, it accounts for maximum (81%) value. We expect that a moderate volume growth and sustained price hike in the segment would continue to drive revenue growth and expansion in margins. Therefore, we have valued the cigarettes business at ₹ 183.1, 26x its FY13E EPS of ₹7.

Exhibit 57: SOTP valuation (₹ per share)



Source: Company, ICICIdirect.com Research

Considering a 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 ₹ 8.3 per share, 1x its price to sales.

We have valued the paper business at 6x its EV/EBITDA per share of ₹11.1 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 ₹ 6.3 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, it 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 ₹ 9.7 per share.
The company has cash and liquid investment worth ₹ 6234.6 crore that accounts for ₹ 8.1 per share.

Exhibit 58: Sum of the parts valuation

SOTP Value		Based on FY13E earnings
Cigarettes	183.1	26x Price to Earning multiple
FMCG	8.3	1x Price to sales
Paper	11.1	6x EV / EBITDA
Agri	6.3	2x Price to Book
Hotels	9.7	2x EV / Room capacity
Cash	8.1	Includes cash and Liquid Investment
Target Price	**226.5**	

Source: Company, ICICIdirect.com Research

Peer comparison

Comparing the cigarettes business with its global peers, British American Tobacco (BAT), Philip Morris and Japan Tobacco, we believe ITC should trade at a premium given the opportunity size of the Indian market and expected higher earnings growth. We are giving a premium multiple to ITC's cigarette business given the company's RoCE being much higher than most of the global peers. Considering ITC's ~2-3% volumes growth in cigarettes and 8-9% price increase in the last 15 years, we believe long-term revenue growth will remain between 11% and 13%. Considering ITC's higher RoCE (~200%) compared to ~40-50% of global peers, the premium multiple is justified.

In the FMCG business, HUL and Nestle are trading at 4-5x FY13E price to sales. Considering ITC's aggressive expansion in different categories like personal care and food business, the company is still at the nascent stage and we believe it would be able to break-even before FY14E in this business. Hence, we have valued the FMCG business at 1x its price to sales (giving significant discount to its peers). Comparing ITC's paperboard business, Ballarpur Industries is trading at 5.8x its FY13E EV/EBITDA. We are valuing ITC's paperboard business at 6x its FY13E EV/EBITDA, considering ITC's margins and return rations are higher compared to Ballarpur Industries but capacity is lower.

Despite Indian Hotels having the largest room capacity, ITC commands a premium as all its properties are in the five star premium category.

Exhibit 59: Peer comparison

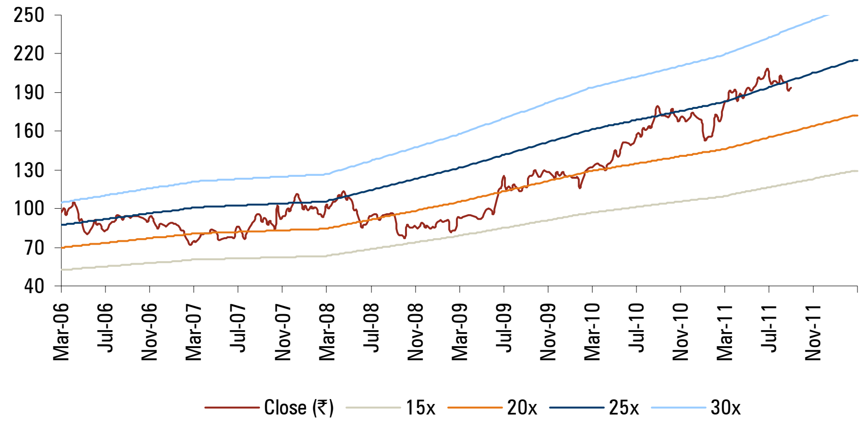
	MCAP (₹ crore)	Sales (₹ crore)	EPS	Price/Earnings(x)	Price/Sales (x)	EV / EBITDA (x)	Price / Book (x)	RoE (%)
Cigarettes								
BAT (UK) - CY12	420974	1246389	2100.0	12.9	3.4	9.9	5.2	41.1
Gudang Garam (Indonesia)-CY12	59962	20335	2983.7	18.5	2.3	12.1	3.8	21.6
Japan Tobacco (Japan)- FY13	240721	142541	24722.0	14.0	1.7	7.2	2.0	16.7
Philip Morris (USA)- CY10	568307	134119	3.9	17.1	4.2	10.8	31.1	145.9
VST Industries (India)-FY13	2066	839	100.5	13.3	2.5	8.4	6.4	52.5
FMCG (others)								
Godrej Consumer-FY13	13264	5281	21.9	18.7	2.5	15.426	5.1	30.1
HUL-FY13	71408	24719	12.9	25.9	2.9	19.99	18.3	78.4
Nestle-CY12	41147	9097	118.4	35.7	4.5	21.709	24.3	85.3
Procter & Gamble	6265	1498	81.0	23.8	4.2	18.565	7.2	33.1
Paper & Paperboard								
Ballarpur Industries- FY13	1824	4827	5.0	5.6	0.4	5.938	0.6	11.1
JK Paper- FY13	540	1315	7.1	5.5	0.4	3.614	0.6	10.4
Hotels								
East India Hotel-FY13	5150	1531	3.0	29.0	3.4	13.39	1.9	6.6
Hotel Leela Venture- FY13	1450	898	0.9	39.6	1.6	14.632	1.2	2.3
Indian Hotels	5233	3807	3.7	18.6	1.4	9.9	1.6	9.4

Source: Bloomberg, ICICIdirect.com Research

Price to earnings

At the current price of ₹ 205, the stock is trading at 23.8x its FY13E EPS of ₹ 8.6 and ₹ 20.3x its FY14E EPS of ₹ 10.1. Historically, the stock has traded in the range of 15-28x. Using price to earnings valuation, giving it a multiple of 26x its FY13E EPS, the intrinsic value for ITC would be ₹ 223 per share.

Exhibit 60: One year rolling price to earnings band (x)

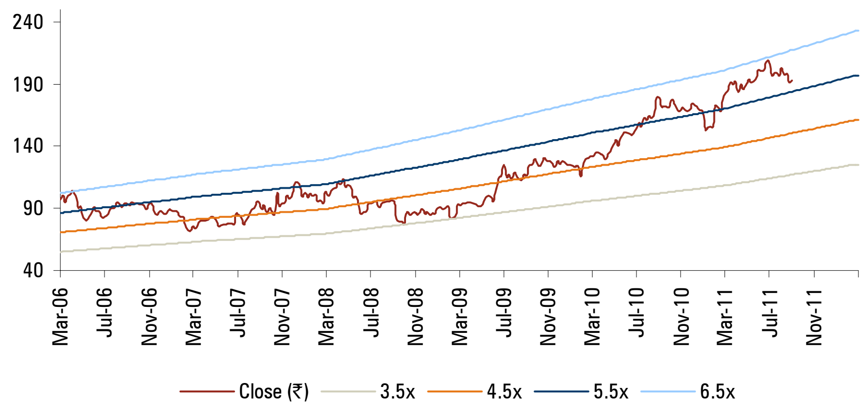


Source: Company, ICICIdirect.com Research

Price to sales

At the current price of ₹ 205, the stock is trading at 5.7x its FY13E to sales per share of ₹ 35.8 and 5.0x its FY14E sales per share of ₹ 41.1. Historically, the stock has traded in the range of 3.5-6.5x its sales per share. Using price to sales valuation, giving it a multiple of 6.5x its FY13E sales per share of ₹ 35.8, the fair value for ITC would be ₹ 232 per share.

Exhibit 61: One year rolling price to sales band (x)



Source: Company, ICICIdirect.com Research

DCF valuation

Using the DCF valuation methodology, we have arrived at a fair value of ₹ 225 per share. We have considered a terminal growth of 5% and WACC (weighted average cost of capital) of 12.2%.

Exhibit 62: WACC calculation

Beta	0.7
Risk Free Return	8%
Market Return	14%
Risk Premium	6%
Cost of Equity	12%
After tax Cost of Debt	6.1%
WACC	**12.2%**

Source: Company, ICICIdirect.com Research

Exhibit 63: DCF Sensitivity analysis

		WACC %				
		11.6%	**11.9%**	**12.2%**	**12.5%**	**12.8%**
Terminal Growth Rate %	**4.0%**	231	219	209	199	190
	4.5%	240	228	216	206	196
	5.0%	251	238	225	214	203
	5.5%	264	249	235	222	211
	6.0%	279	262	247	233	220

Source: Company, ICICIdirect.com Research

Tables

Exhibit 64: Profit & Loss Account (Standalone)

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales	18,153.2	21,167.6	23,891.1	27,702.9	31,822.1
Other Operating Income	239.2	300.7	434.9	463.1	505.6
Total Operating Income	18,392.4	21,468.3	24,326.0	28,166.0	32,327.8
Other Income	375.6	518.2	514.9	543.6	593.6
Total Revenue	**18,767.9**	**21,986.4**	**24,840.9**	**28,709.6**	**32,921.4**
-	-	-	-	-	-
Raw Material Expenses	7,007.3	8,126.5	9,329.2	10,738.9	11,900.0
Employee Expenses	1,002.8	1,159.4	1,517.9	1,689.9	2,004.8
Marketing Expenses	650.9	765.5	835.4	969.6	1,145.6
Administrative Expenses	1,364.9	1,569.3	1,707.8	1,966.9	2,259.4
Power and Fuel	387.3	421.7	507.5	609.5	700.1
Other Operating Expenses	1,116.7	1,323.8	1,264.6	1,482.1	1,782.0
Miscellaneous Expenses	549.3	648.0	663.2	692.6	827.4
Total Operating Expenditure	12,079.2	14,014.1	15,825.5	18,149.5	20,619.3
EBITDA	**6,313.2**	**7,454.1**	**8,500.4**	**10,016.5**	**11,708.5**
Interest	64.8	48.1	54.7	42.7	42.8
Depreciation	608.7	656.0	675.8	734.6	809.6
PBT	6,015.3	7,268.2	8,284.9	9,782.8	11,449.7
Total Tax	1,954.3	2,280.6	2,643.5	3,116.8	3,641.0
PAT	**4,061.0**	**4,987.6**	**5,641.3**	**6,666.0**	**7,808.7**
EPS	**5.2**	**6.4**	**7.3**	**8.6**	**10.1**

Source: Company, ICICIdirect.com Research

Exhibit 65: Balance Sheet (Standalone)

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Equity Capital	381.8	773.8	773.8	773.8	773.8
Reserve and Surplus	13,682.6	15,179.5	16,133.0	17,435.1	19,834.9
Total Shareholders funds	**14,064.4**	**15,953.3**	**16,906.8**	**18,208.9**	**20,608.7**
Secured Loan	-	1.9	11.9	(3.1)	(13.1)
Unsecured Loan	107.7	97.3	87.3	72.3	92.3
Total Debt	**107.7**	**99.2**	**99.2**	**69.2**	**79.2**
Deferred Tax Liability	785.0	801.9	751.9	711.9	691.9
Total Liability	**14,957.1**	**16,854.3**	**17,757.9**	**18,990.0**	**21,379.7**
Total Gross Block	11,967.9	12,765.8	14,265.8	15,965.8	17,765.8
Less Accumulated Depreciation on Tan(	3,821.6	4,416.3	5,092.0	5,826.7	6,636.2
Net Block	8,146.3	8,349.6	9,173.8	10,139.2	11,129.6
Capital WIP	1,009.0	1,333.4	1,433.4	1,533.4	1,533.4
Total Fixed Assets	**9,155.3**	**9,683.0**	**10,607.2**	**11,672.6**	**12,663.0**
Other Investments	1,356.9	1,563.3	1,663.3	1,813.3	1,963.3
Liquid Investments	4,370.0	3,991.3	4,091.3	4,161.3	4,261.3
Inventory	4,549.1	5,267.5	6,514.4	7,147.3	8,545.8
Debtors	858.1	907.6	1,243.6	1,518.0	1,743.7
Loans and Advances	1,306.1	1,418.1	1,448.8	1,875.5	1,943.1
Other Current Assets	288.4	347.5	369.2	406.4	420.9
Cash	1,122.4	2,238.8	1,519.4	1,352.3	2,425.0
Total Current Assets	**8,124.1**	**10,179.5**	**11,095.5**	**12,299.5**	**15,078.5**
Creditors	3,499.1	4,457.9	5,105.5	5,768.3	6,626.0
Provisions	4,549.9	4,104.8	4,594.9	5,191.4	5,963.4
Total Current Liabilities	**8,049.1**	**8,562.8**	**9,700.4**	**10,959.7**	**12,589.4**
Deferred Tax Assets	-	-	1.0	3.0	3.0
Total Asset	**14,957.2**	**16,854.4**	**17,757.9**	**18,990.0**	**21,379.8**

Source: Company, ICICIdirect.com Research

Exhibit 66: Cash Flow Statement (Standalone)

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Profit after Tax	4,061.0	4,987.6	5,641.3	6,666.0	7,808.7
Depreciation	608.7	656.0	675.8	734.6	809.6
Cash Flow before WC	**4,669.7**	**5,643.6**	**6,317.1**	**7,400.6**	**8,618.3**
Inventory	50.7	(718.5)	(1,246.8)	(633.0)	(1,398.4)
Debtors	(189.4)	(49.6)	(336.0)	(274.3)	(225.7)
Loans and Advances	338.9	(112.0)	(30.7)	(426.7)	(67.6)
Other Current Assets	(73.1)	(59.1)	(21.8)	(37.2)	(14.5)
Net Increase in CA	**127.1**	**(939.1)**	**(1,635.4)**	**(1,371.2)**	**(1,706.3)**
Creditors	534.6	958.8	647.5	662.8	857.7
Provisions	2,809.5	(445.1)	490.1	596.5	771.9
Net Increase in CL	**3,344.1**	**513.7**	**1,137.6**	**1,259.3**	**1,629.6**
Net cash from operations	**8,140.9**	**5,218.2**	**5,819.4**	**7,288.7**	**8,541.7**
Deferred Tax Assets	-	-	(1.0)	(2.0)	-
Other Investments	1,480.9	(206.5)	(100.0)	(150.0)	(150.0)
Liquid Investments	(4,370.0)	378.7	(100.0)	(70.0)	(100.0)
(Purchase)/Sale of Fixed Assets	(1,274.8)	(1,183.7)	(1,600.0)	(1,800.0)	(1,800.0)
Deferred Tax Liability	(82.2)	16.8	(50.0)	(40.0)	(20.0)
Net Cash from Investing	**(4,246.1)**	**(994.6)**	**(1,851.0)**	**(2,062.0)**	**(2,070.0)**
Equity Capital	**4.4**	**392.0**	-	-	-
Secured Loan	(11.6)	1.9	10.0	(15.0)	(10.0)
Unsecured Loan	(58.2)	(10.5)	(10.0)	(15.0)	20.0
Outflow on account of dividend	(4,451.7)	(4,001.5)	(4,687.8)	(5,363.9)	(5,409.0)
Adjustments in Reval. Reserve	(0.7)	(1.1)	-	-	-
Securities Premium Account	716.4	511.8	-	-	-
Net Cash from Financing	**(3,801.5)**	**(3,107.2)**	**(4,687.8)**	**(5,393.9)**	**(5,399.0)**
Net Cash flow	93.2	1,116.4	(719.4)	(167.2)	1,072.7
Opening Cash	1,029.2	1,122.4	2,238.8	1,519.4	1,352.3
Cash	**1,122.4**	**2,238.8**	**1,519.4**	**1,352.3**	**2,425.0**

Source: Company, ICICIdirect.com Research

Exhibit 67: Financial Ratios (Standalone)

(Year-end March)	FY10	FY11	FY12E	FY13E	FY14E
Per Share Data					
EPS	5.2	6.4	7.3	8.6	10.1
Cash EPS	6.0	7.3	8.2	9.6	11.1
Cash per Share	1.5	2.9	2.0	1.7	3.1
Revenue per Share	23.5	27.4	30.9	35.8	41.1
Operating profit per share	8.2	9.6	11.0	12.9	15.1
DPS	4.9	4.4	5.2	6.0	6.0
Operating Ratios					
EBITDA / Net Sales	34.8	35.2	35.6	36.2	36.8
EBITDA / Total Operating Income	34.3	34.7	34.9	35.6	36.2
Return Ratios					
RoE	28.9	31.3	33.4	36.6	37.9
RoCE	40.3	42.3	46.0	50.8	52.7
RoNW	28.9	31.3	33.4	36.6	37.9
Valuation Ratios					
P/E	39.1	31.8	28.1	23.8	20.3
Target P/E	43.2	35.1	31.1	26.3	22.4
EV / EBITDA	24.3	20.5	18.0	15.3	13.0
EV / Net Sales	8.4	7.2	6.4	5.5	4.8
Market Cap / Sales	8.7	7.5	6.6	5.7	5.0
Target Market Cap / Sales	9.7	8.3	7.3	6.3	5.5
Dividend yield	2.4	2.2	2.5	2.9	2.9
Turnover Ratios					
Asset turnover	1.2	1.3	1.4	1.5	1.6
Debtors Turnover Ratio	21.2	23.3	19.2	18.3	18.3
Creditors Turnover Ratio	5.2	4.7	4.7	4.8	4.8
Inventory Turnover	4.0	4.3	4.1	4.1	4.1
Solvency Ratios					
Debt / Equity	0.0	0.0	0.0	0.0	0.0
Current Ratio	1.0	1.2	1.1	1.1	1.2
Quick Ratio	0.9	0.9	1.0	1.0	1.0

Source: Company, ICICIdirect.com Research

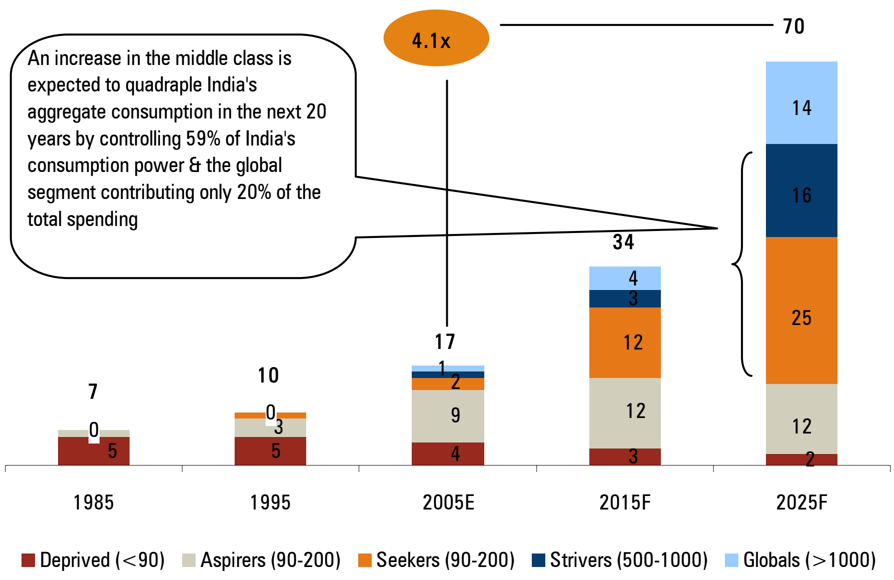
Appendix

Changing demographics, a key positive

According to McKinsey Global Institute's Report, currently, India is the 12th largest consumer market in the world and is expected to become the fifth largest by 2025. India's income growth is expected to accelerate from 6% (1995-2005) to 6.4% (2005-15) and further to 7.4% (2015-2025), thereby making Indian households considerably richer in the next two decades. This increase in income is expected to be driven by the increasing constitution of the Indian working age group population (15-64 years) to ~69% of the total population by 2035 from 63% in 2008. Consequently, rising household incomes and a greater working population is expected to quadruple the aggregate consumption expenditure from ₹ 17 trillion in 2005 to ₹ 70 trillion in 2025. This increase in consumption would make India leap ahead in the ranking among the world's consumption markets.

According to the household disposable income brackets, India's population is divided into five economic groups namely, deprived (less than ₹ 90,000), aspirers (₹ 90,000-2,00,000), seekers (₹ 2,00,000-5,00,000), strivers (₹ 5,00,000-10,00,000) and global Indians (₹ 10,00,000+)

Exhibit 68: India's aggregate consumption across income brackets in trillion ₹ (2000)

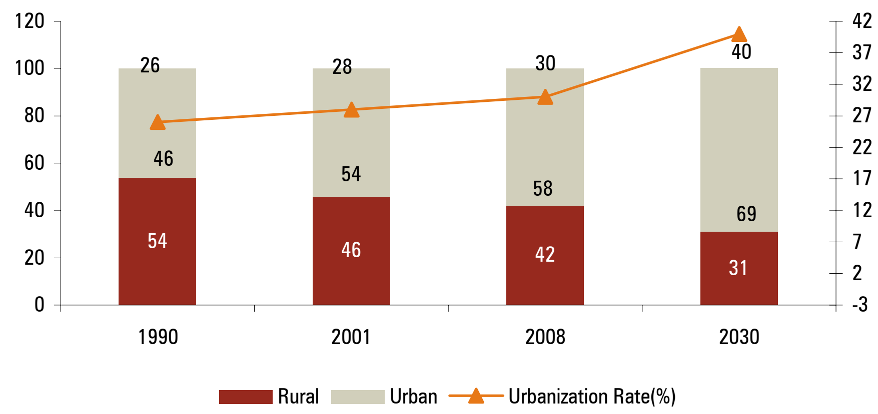


Source: McKinsey Global Research Institute, ICICIdirect.com Research
The figures 7, 10, 17, 34 and 70 refer to total aggregate consumption spending of the country

Today, India is dominated by the aspirers and the deprived classes with only 50 million people (5% of the population) constituting the middle class. By 2015, it is expected that a large chunk of aspirers and seekers will move up the income ladder. Also, by 2025, India will largely be a nation of strivers and seekers with ~41% of the population in the middle class. We believe this change in income distribution would further fuel the demand for branded consumer goods.

Going ahead, India's urbanisation rate is expected to be higher than the rest of the world, increasing from ~30% currently to ~40% by 2030, thereby leading to nuclearization of families and an increase in the proportion of working women, further increasing the demand for branded consumer goods.

Exhibit 69: Urban and rural distribution and urban rate (%)



Source: Company, ICICIdirect.com Research

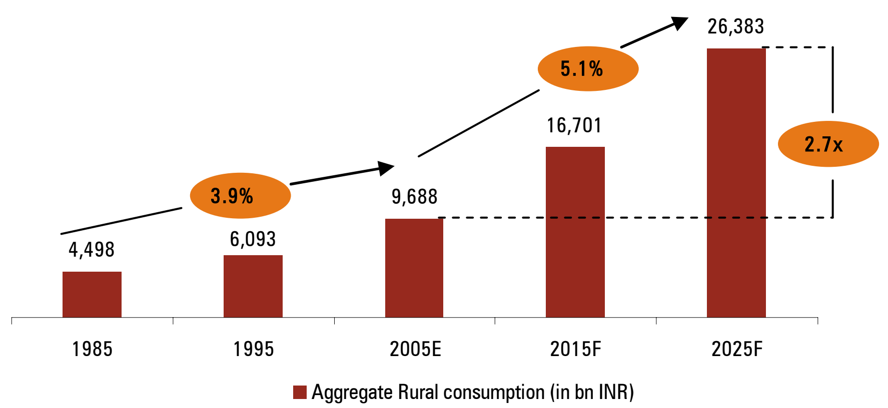
Also, with more than 50% of the Indian population under 25 years of age, much higher than developed countries like the US (~34%), Japan (~23%) and Brazil (~42%), almost ~62% of our population would remain as working class by 2020. This, along with higher degree of urbanisation would pave the way for higher rate of consumption growth.

Robust rural growth cannot be ignored

Currently, rural India constitutes ~70% of the population accounting for more than half of India's consumption. In spite of the increasing urbanisation, McKinsey Global Institute estimates that 63% of the population will continue to live in rural areas in 2025 and the rate of consumption growth there will accelerate from 3.9% CAGR (1985-2005) to 5.1% CAGR (2005-25). Hence, the rural market consumption is expected to almost triple by 2025 to ~₹ 26 trillion, creating a huge opportunity for growth.

In comparison to other countries, in 20 years the rural India market will be larger than the total consumer markets in countries such as South Korea or Canada in 2006 and almost 4x the size of India's urban market (2006)

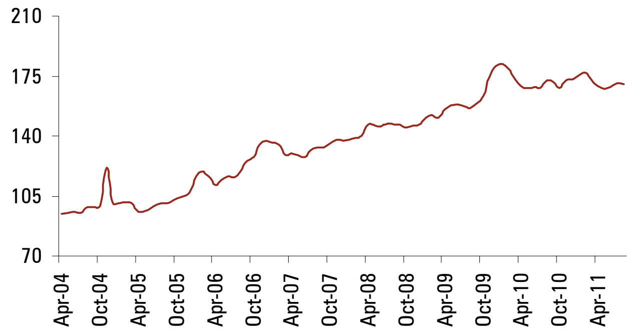
Exhibit 70: Rural consumption growth expected to accelerate over next 20 years



Source: McKinsey Global Research Institute, ICICIdirect.com Research

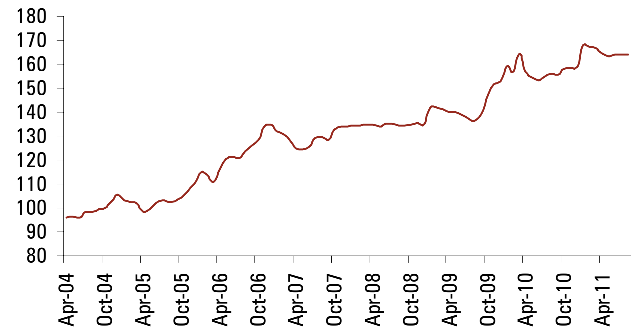
Commodity prices relevant for the company

Exhibit 71: India wholesale price index for wheat



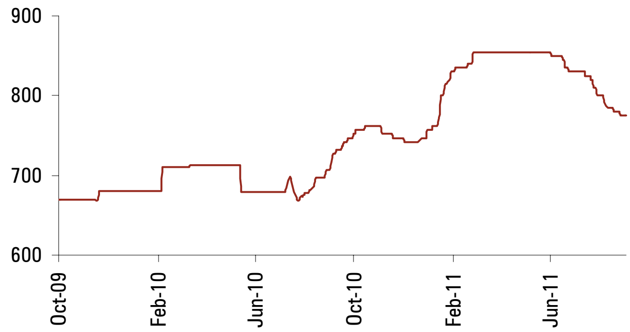
Source: Company, ICICIdirect.com Research

Exhibit 72: India wholesale price index for wheat flour



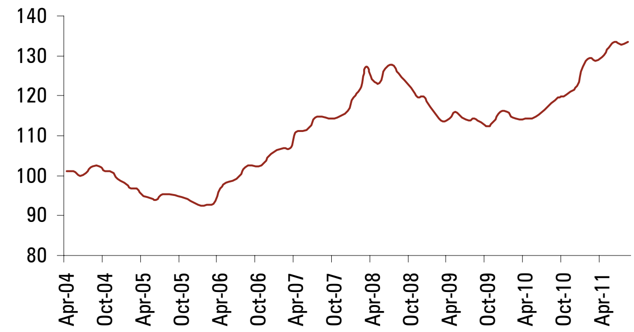
Source: Company, ICICIdirect.com Research

Exhibit 73: Hard wood pulp prices (US$/metric tonne)



Source: Company, ICICIdirect.com Research

Exhibit 74: Edible oil price index

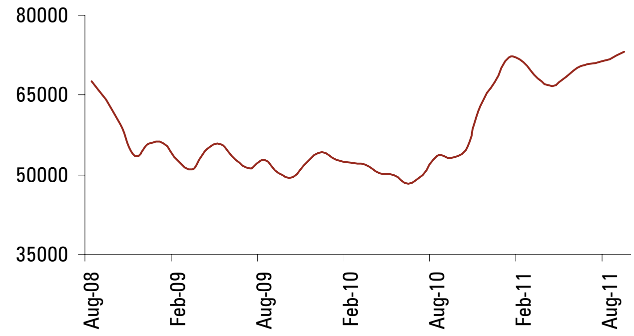


Source: Company, ICICIdirect.com Research

Exhibit 75: Mumbai sugar prices (₹/Quintal)

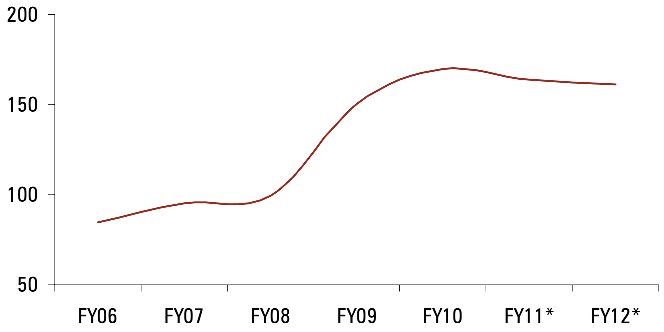
Source: Company, ICICIdirect.com Research

Exhibit 76: Edible soya oil prices (₹/Metric Tonne)



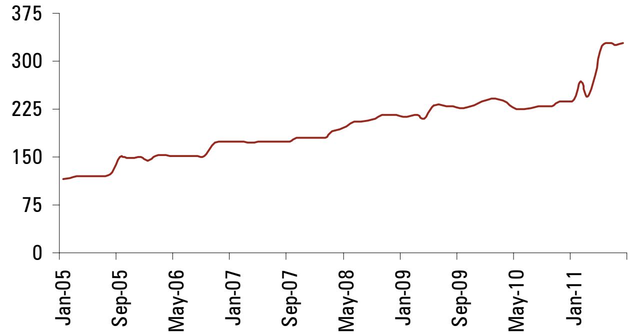
Source: Company, ICICIdirect.com Research

Exhibit 77: Export prices of unmanufactured tobacco (₹/kg)



Source: Company, ICICIdirect.com Research

Exhibit 78: India's wholesale price index for coffee



Source: Company, ICICIdirect.com Research

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