



ITC

BSE SENSEX	S&P CNX	CMP: INR201	TP: INR230										Buy	
16,739	5,049													
Bloomberg	ITC IN	Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/		
Equity Shares (m)	7,738.1	End	(INR M)	(INR M)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA		
52-Week Range (INR)	211/149	03/10A	183,924	40,610	5.1	24.4	39.8	10.9	27.8	38.5	8.2	23.5		
1,6,12 Rel. Perf. (%)	3/23/38	03/11A	214,683	49,876	6.5	22.8	31.0	9.8	33.2	42.9	7.0	19.8		
M.Cap. (INR b)	1,601.0	03/12E	253,594	60,828	7.9	22.0	25.6	8.3	35.0	45.1	5.9	16.5		
M.Cap. (USD b)	32.1	03/13E	293,008	71,267	9.2	17.2	21.9	7.0	34.7	45.6	5.0	13.8		

ITC's 3QFY12 results were above estimates with Adj PAT growth of 22.5% at INR17b (est INR 16.4b) led by higher other income. Total revenues increased 14.2% to INR 62.5b (est INR 64.7b), led by an impressive 24.5% sales growth in FMCG and 17% increase in cigarettes. Cigarette volumes increased ~5%, while FMCG losses declined 36% YoY to INR468m. EBITDA grew 18% to INR23.8b (est INR24.2b); margin expanded 120bp to 38.1% (est 37.4%). Other income increased to INR2.9b (up 48%, est INR1.9b) due to sale of investments in Agrotech Foods and VST Inds shares (estimated profit of ~INR680m). Adj PAT grew 22.5% to INR17b (est 16.4b) as lower FMCG losses and higher other income boosted growth.

10th quarter of 20%+ earnings growth; Strong pricing power and robust growth model makes ITC best placed; Maintain Buy

- ITC has posted 10th consecutive quarter of 20%+ earnings growth.
- **We believe concerns over excise duty hikes are overplayed** as ITC's cigarette business profits have grown at 15% CAGR since 2001 in spite of steep increase in duties in the past; we expect this trend to continue.
- **Payout ratios are likely to settle at higher levels** as compared to historical average of 45%, given limited capex (~INR 10b annually) and INR 50b+ cash flow generation expected in FY12. Higher payouts will not only improve return ratios but also make the stock more attractive.
- **We marginally revise our estimates upwards** to factor in higher profit on sale of investments and a lower tax rate. We expect ITC to report 20% PAT CAGR over FY11-13 as the company's diversification strategy plays out with all divisions contributing to growth.
- **ITC remains our preferred Consumer pick** due to high entry barriers and strong pricing power in cigarette business. **Buy** with target price of INR230.

Quarterly Performance

Y/E March	INR Million									
	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Cigarette Vol Gr (%)	-3.5	-0.5	2.5	-2.0	8.0	7.5	5.0	7.0	-2.0	7.0
Net Sales	48,473	51,756	54,728	59,600	58,602	60,852	62,478	71,661	214,683	253,594
YoY Change (%)	15.5	19.1	19.5	15.9	20.9	17.6	14.2	20.2	16.8	18.1
Total Exp	32,103	32,955	34,550	40,472	38,090	38,662	38,667	48,522	139,944	163,942
EBITDA	16,371	18,802	20,179	19,128	20,512	22,190	23,811	23,139	74,739	89,652
Growth (%)	18.0	18.2	18.2	17.5	25.3	18.0	18.0	21.0	18.6	20.0
Margins (%)	33.8	36.3	36.9	32.1	35.0	36.5	38.1	32.3	34.8	35.4
Depreciation	1,597	1,640	1,681	1,642	1,665	1,701	1,739	2,171	6,560	7,276
Interest	58	106	111	140	165	142	157	287	679	750
Other Income	985	1,245	1,926	1,022	1,438	1,808	2,851	1,336	5,182	7,434
PBT	15,701	18,300	20,313	18,368	20,121	22,155	24,767	22,018	72,682	89,061
Tax	4,998	5,833	6,422	5,553	6,043	7,012	7,757	7,421	22,809	28,232
Rate (%)	31.8	31.9	31.6	30.2	30.0	31.6	31.3	33.7	31.4	31.7
Reported PAT	10,703	12,467	13,891	12,815	14,078	15,143	17,010	14,597	49,873	60,828
YoY Change (%)	21.8	23.5	21.4	24.6	31.5	21.5	22.5	13.9	22.8	22.0

E: MOSL Estimates

- ITC's 3QFY12 results were above estimates with Adj PAT growth of 22.5% at INR17b (est INR 16.4b) led by higher other income. ITC has posted 10th consecutive quarter of 20%+ earnings growth.
- Cigarette volume growth at ~5% was lower than expectations. Margins expanded 170bp YoY as price increases and mix improvement drove profitability despite VAT increase in several states.
- FMCG reported 36% decline in losses and margin improvement despite tough input cost environment and increased pace of new launches; revenue traction was strong at 25% led by healthy volume growth and healthy offtake across categories.
- We believe concerns over excise duty hikes are overplayed as ITC's cigarette business profits have grown at 15% CAGR since 2001 in spite of steep increase in duties in the past; we expect this trend to continue.
- With limited capex requirements (~INR 10b annually) and INR 50b+ cash flow generation expected in FY12, payout ratios are likely to settle at higher levels as compared to historical average of 45%, which will not only improve return ratios but also make the stock more attractive.
- We marginally revise our estimates upwards to factor in higher profit on sale of investments and a lower tax rate. We expect ITC to report 20% PAT CAGR over FY11-13 as the company's diversification strategy plays out with all divisions contributing to growth.
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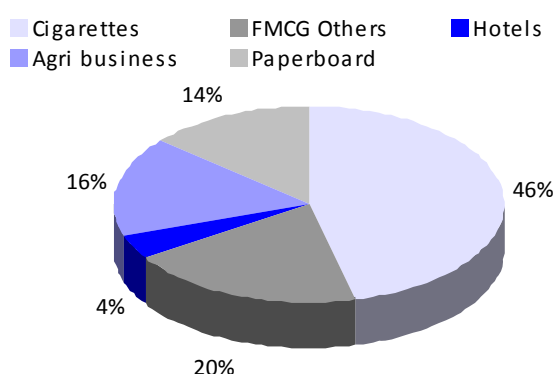
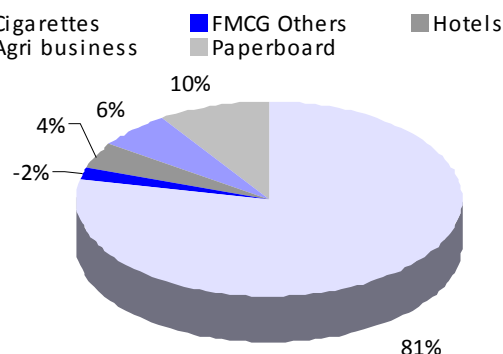
Sales up 14.2% on robust growth in FMCG others; Other income boosts PAT growth

- **Total revenues increased 14.2%** to INR 62.5b (est INR 64.7b), led by an impressive 24.5% sales growth in FMCG and 17% increase in cigarettes. Cigarette volumes increased ~5%, while FMCG losses declined 36% YoY to INR468m. 3Q losses are the lowest in the last 16 quarters.
- **EBITDA grew 18%** to INR23.8b (est INR24.2b); margin expanded 120bp to 38.1% (est 37.4%). Other income increased to INR2.9b (up 48%, est INR1.9b) due to sale of investments in Agrotech Foods and VST Inds shares (estimated profit of ~INR680m). Adj PAT grew 22.5% to INR17b (est 16.4b) as lower FMCG losses and higher other income boosted growth.

Segmental Performance; Strong margin expansion in Cigarettes, Hotels and FMCG

	FY11				FY12			% gr.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	
Sales (INR m)								
Cigarettes	24,836	25,501	27,726	27,673	28,736	29,681	32,328	16.6
FMCG - Others	10,014	10,556	11,021	13,125	11,978	13,407	13,707	24.4
Hotels	2,099	2,089	2,816	3,003	2,305	2,111	2,787	-1.0
Agri business	13,498	12,719	10,375	10,818	17,071	14,345	11,394	9.8
Paper and packaging	7,937	9,192	8,773	9,170	9,596	10,054	9,784	11.5
EBIT (INR m)								
Cigarettes	13,050	14,582	15,330	14,706	15,767	17,289	18,442	20.3
FMCG - Others	-893	-669	-736	-678	-763	-559	-468	-36.4
Hotels	385	399	886	996	513	434	1,017	14.8
Agri business	1,231	2,076	1,292	998	1,571	2,388	1,417	9.7
Paper and packaging	1,885	2,456	1,914	1,937	2,270	2,897	2,243	17.2
EBIT Margin (%)								
Cigarettes	52.5	57.2	55.3	53.1	54.9	58.2	57.0	1.8
FMCG - Others	-8.9	-6.3	-6.7	-5.2	-6.4	-4.2	-3.4	3.3
Hotels	18.3	19.1	31.5	33.2	22.3	20.6	36.5	5.0
Agri business	9.1	16.3	12.5	9.2	9.2	16.6	12.4	0.0
Paper and packaging	23.7	26.7	21.8	21.1	23.7	28.8	22.9	1.1

Source: Company/MOSL

3QFY12 sales mix**3QFY12 PBIT mix**

Source: Company/MOSL

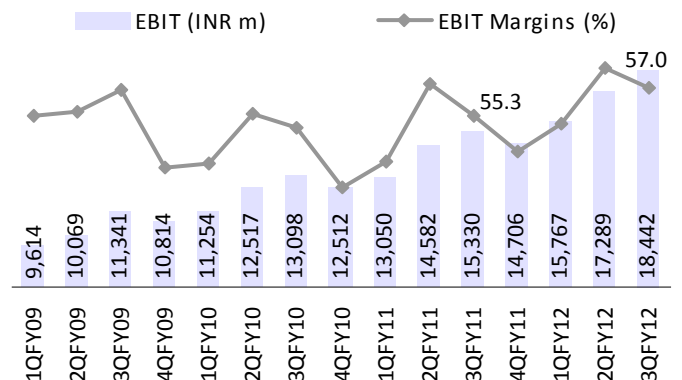
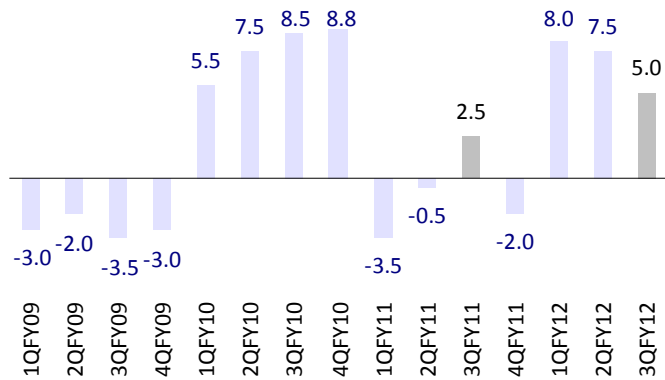
Cigarette volumes up ~5%; price increases, improved product mix enable 170bp margin expansion

- 3QFY12 cigarette volumes increased ~5% YoY on a higher base (2.5% volume growth due to increase in pipeline filling before pictorial warning guideline change; highest volume growth quarter in FY11). However, secondary sales trend remains healthy with strong growth in premium segment and new launches like Players, Classic Citric Twist and Hero during the quarter.
- ITC's average price hike was 1-1.5% - Gold Flake Kings (by 10%), Scissors (by 11%) and Benson & Hedges (by 4%). We expect ITC to undertake preemptive price increases ahead of budget in anticipation of double digit increase in cigarette excise duties, more so as FY12 saw no hikes.
- Net sales grew 16.6% to INR 32.3b led by ~6% realization growth and ~5% volume growth.

- EBITDA Margin expanded 170bp to 57% on the back of price increases and continued mix improvement, despite VAT increase in a few states in 1HFY12 which were not fully passed on to consumers.
- We remain positive on volume growth in cigarettes over the long term. However, a sharp, above mid-teens hike in excise duty remains a key risk to our FY13 volume growth estimate (+6%).

Cigarette 3Q volume growth lower at 5% due to high base

Price hike, improved mix enable 170bp margin expansion



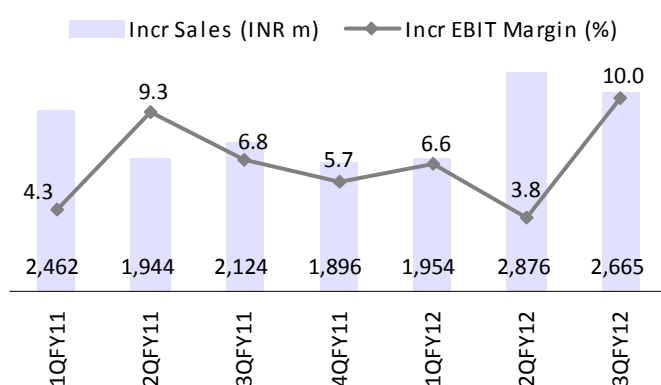
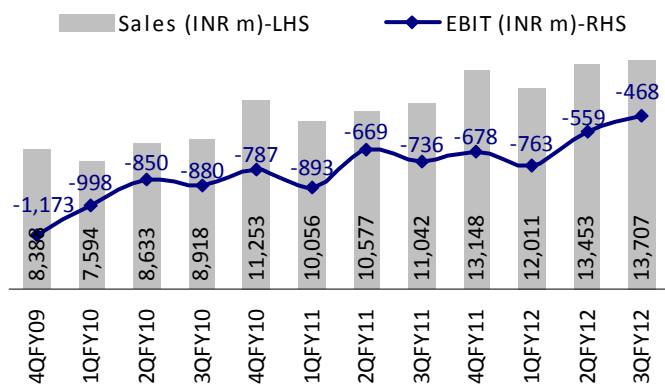
Source: Company/MOSL

FMCG: Impressive sales growth of 25%; Strong growth across product segments; EBIT losses decline 36% YoY

- FMCG sales increased 24.5% YoY to INR 13.7b and EBIT loss declined 36% to INR468m. Incremental EBIT margins were higher at 10% indicating higher growth in packaged foods and education and stationery segments.
- Packaged Foods sales posted strong growth with volume growth and profitability picking up. Growth was led by biscuits (Sunfeast launching new variants at the premium end), atta (Aashirwad growing in volumes and realizations) and Bingo. The company continues to invest in infrastructure to support the increased scale being achieved in foods. We believe the premiumization strategy in biscuits is driving margins for ITC's food products.
- Personal care traction remains strong, with new launches in soaps, shampoos and increased distribution led growth in skin care. Vivel Activ Fair fairness cream is performing well across markets and the company is also satisfied with its launch in the domestic talc market (Fiama Di Wills Face and Body Talc).
- Lifestyle retail posted healthy growth; however signs of slackening consumer demand are visible.
- Pace of decline in losses has accelerated with the food division (65% of FMCG sales) on a profitable growth path. We expect all FMCG segments excluding personal care to be EBIT positive by the end of FY12.

FMCG: 25% revenue growth; losses decline 36% YoY

All-time high EBIT margins on incremental sales in FMCG

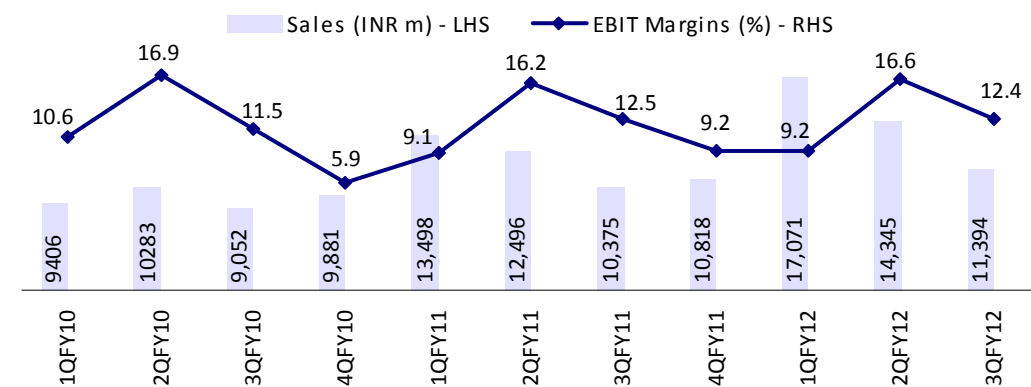


Source: Company/MOSL

Agri business: 10% sales growth; higher trading volumes and realizations in wheat and leaf

- Agri business reported 10% increase in sales to INR11.4b while EBIT grew 10% YoY with margins contracting marginally by 10bp to 12.4%.
- Growth in the division has been led by higher volumes and realizations of leaf tobacco and wheat.
- The leaf tobacco threshing facility in Mysore has commenced trial production. We expect this unit to accelerate sales growth and improve margins.
- Growth traction in agri business remains healthy; we believe the rupee depreciation, though positive, is unlikely to provide proportionate gains.

Higher wheat and leaf volumes and realizations drive growth

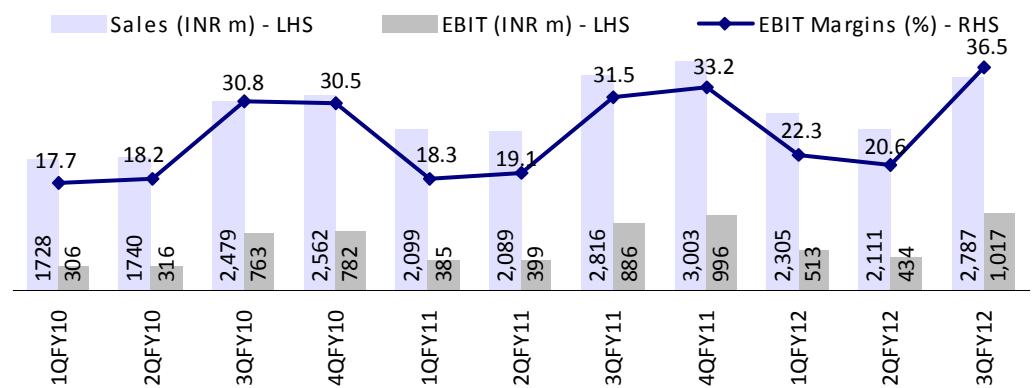


Source: Company/MOSL

Hotels business: Sales growth flat; EBIT margins up 500bp YoY

- Hotel revenues disappointed with sales declining 1% to INR2.8b. EBIT margins improved 500bp to 36.5%, largely due to cost cutting measures.
- Lower foreign tourist arrivals from Europe and USA due to a weak global economic situation led to lower demand; increasing supply in the industry kept occupancies and average room rates flat which led to a difficult quarter.
- Construction of Chennai, Kolkatta and Gurgaon properties are progressing satisfactorily.
- We expect improvement in growth rates in Q4FY12 led by lower base; however growth will continue to be moderate and recovery in the industry is only expected to be gradual.

Impacted by slowdown in FTA; cost cutting enables margin expansion of 500bp

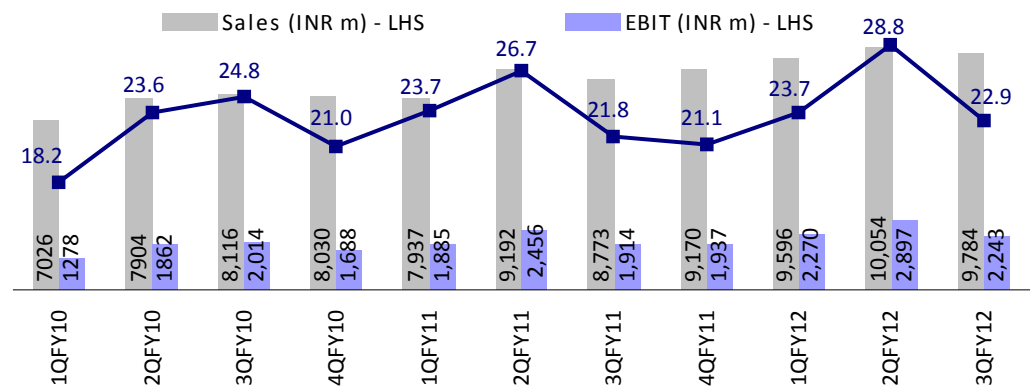


Source: Company/MOSL

Paper and paperboard: 9.8% sales growth mix driven; margins expand 110bp in spite of higher input costs

- Paper and paperboard sales increased 9.8% YoY to INR9.8b while EBIT increased by 17.2% YoY to INR 2.2b.
- Sales was muted due to lack of capacity and the growth was almost entirely mix driven. In spite of higher fuel and fibre costs, improved mix and efficient backward integration benefits led to 110bp margin expansion.
- Commissioning of another paperboard line of 0.1m tons will boost sales growth in FY13; however, margins are likely to be lower on account of higher depreciation costs on the new machine. Lower pulp prices can also impact realizations in commodity segments.

Revenue growth mix led; margins continue to stay strong



Source: Company/MOSL

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Sales growth and EBIT margins for various segments (INR m)

	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Sales						
Cigarettes	66,350	77,807	93,212	105,737	124,777	142,493
FMCG	25,096	30,056	36,339	44,716	55,592	64,784
Hotels	10,121	9,355	8,507	10,008	10,760	12,181
Agri Business	38,684	38,460	38,621	47,480	55,712	65,943
Paperboards & Paper	21,579	26,471	31,078	35,072	39,728	45,443
	161,830	182,148	207,757	243,013	286,569	330,845
Sales Growth						
Cigarettes	12.6	17.3	19.8	13.4	18.0	14.2
FMCG	48.5	19.8	20.9	23.1	24.3	16.5
Hotels	11.7	-7.6	-9.1	17.6	7.5	13.2
Agri Business	10.5	-0.6	0.4	22.9	17.3	18.4
Paperboards & Paper	12.9	22.7	17.4	12.9	13.3	14.4
EBIT						
Cigarettes	36,340	41,838	49,381	57,668	69,251	79,796
FMCG	-2,635	-4,835	-3,495	-2,976	-2,224	-1,425
Hotels	4,108	3,162	2,166	2,666	3,041	3,840
Agri Business	1,292	2,562	4,478	5,663	6,685	7,913
Paperboards & Paper	4,531	5,086	6,843	8,192	9,443	10,944
EBIT Margin (%)						
Cigarettes	54.8	53.8	53.0	54.5	55.5	56.0
FMCG	-10.5	-16.1	-9.6	-6.7	-4.0	-2.2
Hotels	40.6	33.8	25.5	26.6	28.3	31.5
Agri Business	3.3	6.7	11.6	11.9	12.0	12.0
Paperboards & Paper	21.0	19.2	22.0	23.4	23.8	24.1
EBIT Growth (%)						
Cigarettes	14.6	15.1	18.0	16.8	20.1	15.2
FMCG	30.5	83.5	-27.7	-14.9	-25.3	-35.9
Hotels	17.1	-23.0	-31.5	23.0	14.1	26.3
Agri Business	4.6	98.3	74.8	26.5	18.1	18.4
Paperboards & Paper	8.7	12.2	34.5	19.7	15.3	15.9

ITC: an investment profile

Company description

ITC is an associate of BAT (British American Tobacco) controls more than 2/3rd of the cigarette market in India. ITC has emerged as a diversified conglomerate with leading presence in Paperboards, Hotels and Processed foods. E-Choupal, the agri rural initiative of the company has been widely appreciated for its foresight in harnessing the potential in the rural market.

Key investment arguments

- Strong pricing power due to dominant market share in the cigarettes.
- Paperboard businesses has achieved self sustenance levels.
- Hotel business on a steady recovery

Key investment risks

- Increase in excise in the forthcoming budget could be a risk factor for the volume growth assumption in cigarette.
- Higher than expected losses in New FMCG business will impact profitability.

Recent developments

- ITC has entered high growth instant noodles market with Sunfeast Yippies brand.
- ITC has planned addition of 1,500 rooms in the coming 3-4 years (addition of ~50% of existing capacity).
- Strong mix improvement in Paper and Paperboard due higher share of value added products.

Valuation and view

- Our EPS estimates stand at Rs7.9 for FY12 and Rs9.2 for FY13. We estimate 20% PAT CAGR over FY11-13.
- The stock trades at 25.6x FY12E EPS and 21.9x FY13E EPS. Maintain Buy with target price of INR 230.

Sector view

- We are positive on long term demand growth in cigarette business due to rising affordability and huge demand potential in small towns and rural areas.
- Non Cigarette businesses like Hotels, paper can fund their own growth; demand potential continues to be strong.

Comparative valuations

		ITC	HUL	Nestle
P/E (x)	FY12E	25.6	33.3	39.3
	FY13E	21.9	28.7	33.2
EV/EBITDA (x)	FY12E	16.5	24.8	25.8
	FY13E	13.8	21.2	21.2
EV/Sales (x)	FY12E	5.9	3.6	5.3
	FY13E	5.0	3.2	4.3
P/BV (x)	FY12E	8.3	25.5	31.7
	FY13E	7.0	20.6	23.3

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	7.9	7.8	0.9
FY13	9.2	9.2	-0.4

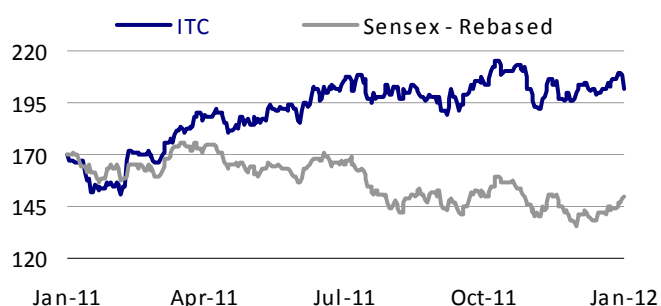
Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
201	230	14.2	Buy

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	0.0	0.0	0.0
Domestic Inst	34.8	35.2	35.9
Foreign	48.1	47.2	46.3
Others	17.1	17.6	17.8

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Net Sales	156,119	181,532	211,676	250,073	289,175	
Operational Incon	1,946	2,392	3,007	3,521	3,833	
Total Revenue	158,065	183,924	214,683	253,594	293,008	
Change (%)	11.5	16.4	16.7	18.1	15.5	
Total Expenditure	107,341	120,619	139,944	163,942	187,895	
EBITDA	50,724	63,305	74,739	89,652	105,113	
Change (%)	8.9	24.8	18.1	20.0	17.2	
Margin (%)	32.5	34.9	35.3	35.9	36.3	
Depreciation	5,494	6,087	6,560	7,276	8,041	
Int. and Fin. Charg	376	820	679	750	750	
Other Inc. - Recurri	3,403	3,756	5,182	7,434	7,717	
Profit before Taxes	48,257	60,153	72,682	89,061	104,039	
Change (%)	5.6	24.7	20.8	22.5	16.8	
Margin (%)	30.9	33.1	34.3	35.6	36.0	
Tax	12,550	20,511	22,809	27,787	32,252	
Deferred Tax	3,071	968	3	445	520	
Tax Rate (%)	32.4	32.5	31.4	31.7	31.5	
Profit after Taxes	32,636	40,610	49,876	60,828	71,267	
Change (%)	4.6	24.4	22.8	22.0	17.2	
Margin (%)	20.9	22.4	23.6	24.3	24.6	
Non-rec. (Exp)/Incc	0	0	0	0	0	
Reported PAT	32,636	40,610	49,876	60,828	71,267	

Balance Sheet		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Share Capital	3,774	3,818	7,738	7,738	7,738	
Reserves	133,576	136,826	151,795	180,597	214,342	
Net Worth	137,351	140,644	159,533	188,335	222,080	
Loans	1,776	1,077	992	992	992	
Deferred Liability	8,672	7,850	8,019	7,227	6,327	
Capital Employed	147,798	149,571	168,543	196,554	229,399	
Gross Block	105,587	119,679	127,658	142,658	157,658	
Less: Accum. Depn	32,867	38,255	44,208	51,483	59,524	
Net Fixed Assets	72,719	81,424	83,451	91,175	98,135	
Capital WIP	12,141	10,090	13,334	10,000	10,000	
Investments	28,378	57,269	55,547	67,973	92,073	
Curr. Assets, L&A	81,597	81,279	101,840	109,176	123,503	
Inventory	45,997	45,491	52,675	62,747	71,511	
Account Receivabl	6,687	8,581	9,076	11,647	13,468	
Cash and Bank Ba	10,310	11,263	22,432	13,134	14,594	
Others	18,603	15,945	17,656	21,648	23,930	
Curr. Liab. and Prov.	47,036	80,491	85,628	81,770	94,311	
Account Payables	29,237	34,449	43,821	47,779	54,627	
Other Liabilities	3,833	7,859	7,371	6,617	7,613	
Provisions	13,966	38,183	34,436	27,374	32,071	
Net Current Assets	34,561	788	16,212	27,406	29,191	
Application of Funds	147,798	149,571	168,543	196,554	229,399	

E: MOSL Estimates

Ratios		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Basic (INR)						
EPS	8.6	10.1	6.4	7.9	9.2	
Cash EPS	10.1	11.7	7.3	8.8	10.2	
BV/Share	18.2	18.4	20.6	24.3	28.7	
DPS	3.7	10.0	4.5	3.5	4.1	
Payout %	49.9	115.1	80.2	52.7	52.7	
Valuation (x)						
P/E	23.3	19.9	31.2	25.6	21.9	
Cash P/E	24.8	29.8	27.6	22.9	19.6	
EV/Sales	9.7	8.2	7.0	5.9	5.0	
EV/EBITDA	30.0	23.5	19.8	16.5	13.8	
P/BV	11.1	10.9	9.8	8.3	7.0	
Dividend Yield (%)	1.8	5.0	2.2	1.8	2.1	
Return Ratios (%)						
RoE	25.3	27.8	33.2	35.0	34.7	
RoCE	32.8	38.5	42.9	45.1	45.6	
Working Capital Ratios						
Debtor (Days)	16	15	15	15	16	
Asset Turnover (x)	1.1	1.2	1.3	1.3	1.3	
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

Cash Flow Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
OP/(loss) before T	48,257	60,153	72,682	89,061	104,039	
Int./Div. Received	3,403	3,756	5,182	7,434	7,717	
Depreciation and	5,494	6,087	6,560	7,276	8,041	
Interest Paid	376	820	679	750	750	
Direct Taxes Paid	15,622	21,480	22,812	28,232	32,772	
Incr in WC	2,648	-6,956	1,827	32,919	24,426	
Diff in dep	535	700	607	0	0	
CF from Operations	32,990	49,481	50,707	28,501	47,915	
Extraordinary Item	0	0	0	1	2	
Incr Decr in FA	16,862	12,041	11,224	11,666	15,000	
Pur of Investment:	-968	28,891	-1,722	12,427	24,100	
CF from Invest.	-15,894	-40,933	-9,502	-24,092	-39,098	
Issue of shares	448	7,207	5,220	0	0	
Incr in Debt	-698	-85	0	0	0	
Interest Income	3,403	3,756	5,182	7,434	7,717	
Interest Paid	376	820	679	750	750	
Dividend Paid	13,190	13,965	38,182	34,435	27,373	
Others	-2,075	-3,688	-1,576	13,530	12,846	
CF from Fin. Activity	-12,489	-7,596	-30,035	-14,221	-7,560	
Incr of Cash	4,607	953	11,170	-9,811	1,257	
Add: Opening Bal:	5,703	10,310	11,263	22,432	13,134	
Closing Balance	10,310	11,263	22,433	12,621	14,391	

N O T E S

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