

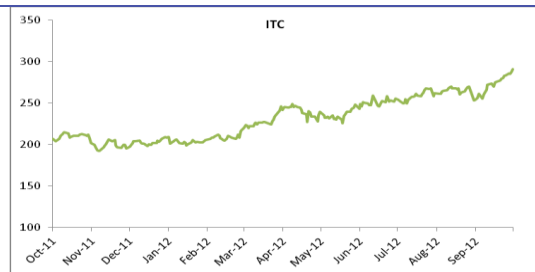
ITC Ltd.

| | |
|----------------|---------|
| Recommendation | HOLD |
| CMP | Rs. 298 |
| Target Price | Rs. 317 |
| Sector | FMCG |

Stock Details

| | |
|-----------------------------|---------|
| BSE Code | 500875 |
| NSE Code | ITC |
| Bloomberg Code | ITC IN |
| Market Cap (Rs cr) | 195030 |
| Free Float (%) | 100% |
| 52- wk HI/Lo (Rs) | 299/189 |
| Avg. volume BSE (Quarterly) | 367960 |
| Face Value (Re) | 1.00 |
| Shares o/s (Cr) | 782.3 |

| Relative Performance | 1Mth | 3Mth | 1Yr |
|----------------------|-------|-------|-------|
| ITC | 14.7% | 14.4% | 40.7% |
| Sensex | 1.6% | 9.4% | 10.0% |



| Shareholding Pattern | 30 th Sept 12 |
|----------------------------------|--------------------------|
| Institutional (Incl. FII) | 53.0% |
| Corporate Bodies (incl. foreign) | 36.4% |
| Public & others | 10.6% |

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Smoking Performance!!!

ITC's second quarter net profit rose better than consensus estimates by 21% YoY to Rs 1836 crores, helped especially by strong growth in its Other FMCG and Agri business. ITC continues to see robust growth in its core cigarettes and other FMCG business, which includes processed foods and personal care products. The Cigarette margin improved YoY by 320bps and by 390bps on QoQ basis driven by the price hike, better product mix (new launch in the >65mm filter category as in FY13 budget the excise rates were kept unchanged). The increase in the cigarette margin shows the ITC's pricing power and also the new addition of cigarette consumers every year will keep the demand of cigarettes un-deterred. ITC has taken a judiciously price hike in cigarette and Other FMCG during the quarter supported the revenue growth and expansion in margin in Q2FY13. The Other FMCG business has started to narrow losses which in our view will attain break even in 1HFY14E.

Standalone Net Sales for Q2FY13 went up by 19% YoY to Rs. 7227 crores and up by 8% QoQ. The company posted remarkable revenue growth primarily driven by 41% YoY growth in Agri business, 26% YoY growth in Other FMCG business and 14% YoY growth in Cigarette business.

EBITDA increased by 21% YoY to Rs. 2688 crores in Q2FY13 and by 14% QoQ. The cigarette segment reported a strong EBIT growth of 20% YoY. EBIT margins for the cigarette increased by 320bps YoY to 61.4%, driven largely by price increase taken during the quarter and product mix improvement. Other FMCG revenues grew by 26% YoY even as segment losses reduced by 46% YoY. Paperboard reported a decline in EBIT margin by 210bps YoY to 26.7% due to steep rise in input price particularly wood. Agri business reported a decline in EBIT margin by 380bps YoY to 12.8%. Hotel continues to report subdued performance where the EBIT margin is declined by 1350bps YoY due to weak economic conditions. The Company reported an EBITDA margin of 37.6% in Q2FY13, as compared to 37.1% in Q2FY12 and 35.6% in Q1FY13.

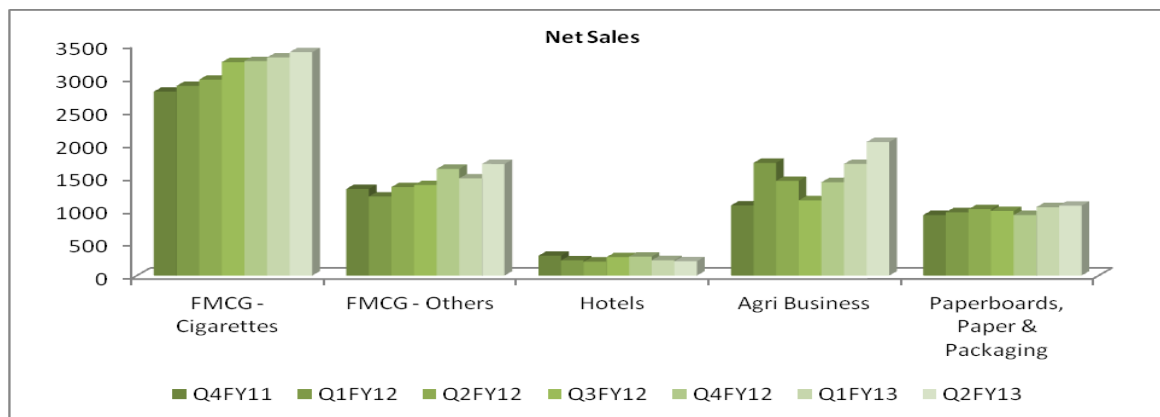
Valuation & Recommendation

We forecast ITC's sales to rise at a CAGR of 15.7% for FY12-14, with most segments recording relatively steady growth over the next two years. We have forecasted flat sales-volume in Cigarette business for FY13E and sales-volume growth of 5% YoY for FY14E. We are positive on ITC due to its strong pricing power and strong earnings growth visibility which is likely to support valuations. Many states have banned or are in the process to ban chewing tobacco which would encourage steady shift to cigarettes, in our view. **We feel that the government effort to curb tobacco consumption may affect sentiments, but fundamentally, there will be no major impact on ITC. At CMP of Rs. 298 per share, the stock is trading at a PE of 32.3x FY13E & 27.4x FY14E. We recommend "HOLD" rating and revised our target price of Rs. 317 per share (earlier Rs. 266 per share) based on SOTP (FY14E).**

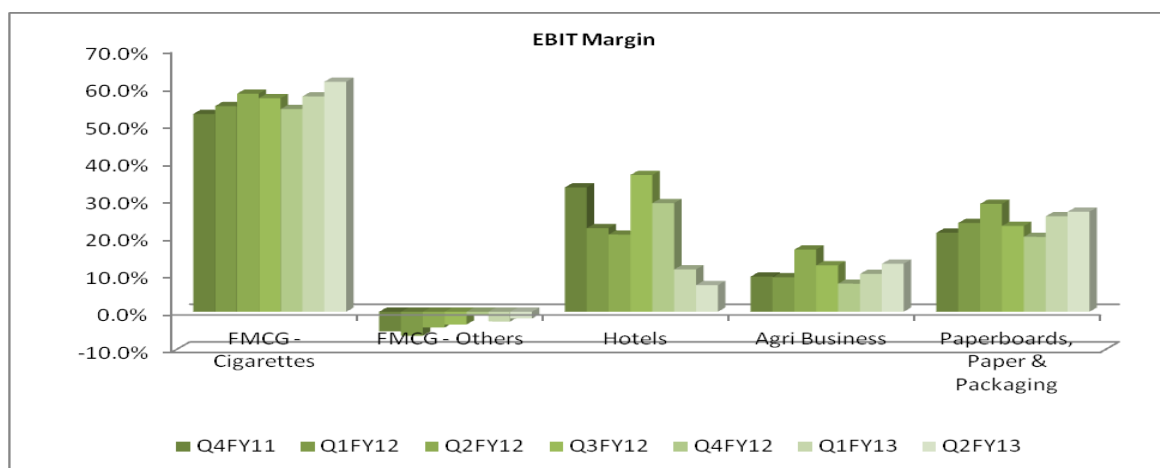
| Year | Net Sales (Rs cr) | Growth (%) | EBIDTA | Margin (%) | PAT (Rs cr) | Margin (%) | EPS (Rs.) | P/E (x) | P/BV (x) | RoE |
|-------|-------------------|------------|---------|------------|-------------|------------|-----------|---------|----------|-------|
| FY11 | 22279.1 | 16.4% | 8204.9 | 33.1% | 5017.9 | 22.5% | 6.5 | 45.9 | 14.0 | 32.4% |
| FY12 | 26179.5 | 17.5% | 9994.1 | 33.8% | 6258.1 | 23.9% | 8.0 | 37.2 | 12.0 | 34.8% |
| FY13E | 30166.0 | 15.2% | 11786.5 | 34.9% | 7201.1 | 23.9% | 9.2 | 32.3 | 10.1 | 33.8% |
| FY14E | 35037.9 | 16.2% | 13787.1 | 35.6% | 8480.2 | 24.2% | 10.8 | 27.4 | 8.8 | 34.2% |

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Annexure:



Source: Company & Nirmal Bang Research



Source: Company & Nirmal Bang Research

SOTP Valuation: FY14E

| | EV/EBIDTA (x) | Rs. / share |
|---------------------------|---------------|-------------|
| Cigarettes | 20 | 246 |
| FMCG Others (EV/Sales) | 3 | 29 |
| Hotels | 12 | 9 |
| Agri Business | 8 | 7 |
| Paper | 5 | 9 |
| Net (debt)/Cash per share | | 17 |
| Target Price | | 317 |

Source: Nirmal Bang Research

We have increased the multiple of Cigarettes from 17x to 20x as the company has shown resilient towards the cigarette business by taking price hike, change in product mix which has resulted into the continuous improvement in EBIT margin for the past couple of quarters. We have also increased the multiple of Other FMCG business from 2x to 3x owing to the reduced losses and ability of the company to take price hike. However, we have reduced the multiple of Hotel business from 15x to 12x as the industry is marred by the adverse economic condition resulting into the poor performance for the past couple of quarters and ITC's investment of Rs. 10,000 crores in this segment poses a matter of concern.

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Q2FY13 Result Analysis

Rs. in crores

| Particulars | Q2FY13 | Q2FY12 | YoY% | Q1FY13 | QoQ% |
|--|----------------|----------------|--------------|----------------|--------------|
| Net Sales | 7146.0 | 5974.18 | 19.6% | 6652.21 | 7.4% |
| Other Operating Income | 80.58 | 111.04 | -27.4% | 60.86 | 32.4% |
| Total Income | 7226.58 | 6085.22 | 18.8% | 6713.07 | 7.6% |
| Increase / Decrease in Stock | -318.06 | -39.84 | 698.3% | -249.56 | 27.4% |
| Consumption of raw material | 2079.41 | 1856.04 | 12.0% | 2068.27 | 0.5% |
| Purchase of traded goods | 1103.03 | 502.94 | 119.3% | 757.91 | 45.5% |
| Employees Cost | 289.24 | 265.04 | 9.1% | 412.45 | -29.9% |
| Other Expenditure | 1384.69 | 1282.05 | 8.0% | 1355.66 | 2.1% |
| Total Expenditure | 4538.31 | 3866.23 | 17.4% | 4344.73 | 4.5% |
| EBITDA | 2688.27 | 2218.99 | 21.1% | 2368.34 | 13.5% |
| Interest | 23.29 | 14.18 | 64.2% | 13.76 | 69.3% |
| Other Income | 184.98 | 180.8 | 2.3% | 176.76 | 4.7% |
| PBDT | 2849.96 | 2385.61 | 19.5% | 2531.34 | 12.6% |
| Depreciation | 188.86 | 170.13 | 11.0% | 194.79 | -3.0% |
| Tax | 824.68 | 701.17 | 17.6% | 734.41 | 12.3% |
| Reported Profit After Tax (PAT) | 1836.42 | 1514.31 | 21.3% | 1602.14 | 14.6% |
| EPS (Unit Curr.) | 2.35 | 1.96 | | 2.05 | |
| Equity | 782.29 | 773.81 | | 782.29 | |
| Face Value | 1 | 1 | | 1 | |
| EBITDA(%) | 37.6% | 37.1% | | 35.6% | |
| PBDT(%) | 39.9% | 39.9% | | 38.1% | |
| PAT(%) | 25.7% | 25.3% | | 24.1% | |

Source: Company and Nirmal Bang Research

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Segment Analysis

| Particulars | Rs. in crores | | | | |
|--|----------------|----------------|--------------|----------------|--------------|
| | Q2FY13 | Q2FY12 | YoY% | Q1FY13 | QoQ% |
| FMCG - Cigarettes | 3385.15 | 2968.14 | 14.0% | 3304.24 | 2.4% |
| FMCG - Others | 1690.8 | 1340.66 | 26.1% | 1473.05 | 14.8% |
| Hotels | 216.96 | 211.14 | 2.8% | 232.35 | -6.6% |
| Agri Business | 2023.68 | 1434.54 | 41.1% | 1691.42 | 19.6% |
| Paperboards, Paper & Packaging | 1059 | 1005.42 | 5.3% | 1036.12 | 2.2% |
| Total | 8375.59 | 6959.9 | 20.3% | 7737.18 | 8.3% |
| Profit / Loss before Interest & Tax | | | | | |
| FMCG - Cigarettes | 2080.17 | 1728.9 | 20.3% | 1899.81 | 9.5% |
| FMCG - Others | -30.3 | -55.9 | -45.8% | -38.84 | -22.0% |
| Hotels | 15.3 | 43.44 | -64.8% | 26.23 | -41.7% |
| Agri Business | 259.74 | 238.78 | 8.8% | 171.37 | 51.6% |
| Paperboards, Paper & Packaging | 282.53 | 289.7 | -2.5% | 264.71 | 6.7% |
| Total | 2607.44 | 2244.92 | 16.1% | 2323.28 | 12.2% |
| Less: | | | | | |
| Interest (Net) | 23.29 | 14.18 | | 13.76 | |
| Other un-allocable income net of un-allocable exp. | -76.96 | 15.26 | | -27.03 | |
| Profit before Tax | 2661.11 | 2215.48 | | 2336.55 | |
| Less: Tax Expense | 824.68 | 701.17 | | 734.41 | |
| Profit After Tax | 1836.43 | 1514.31 | 21.3% | 1602.14 | 14.6% |
| EBIT Margin | | | | | |
| FMCG - Cigarettes | 61.4% | 58.2% | 320 | 57.5% | 390 |
| FMCG - Others | -1.8% | -4.2% | 240 | -2.6% | 80 |
| Hotels | 7.1% | 20.6% | -1350 | 11.3% | -420 |
| Agri Business | 12.8% | 16.6% | -380 | 10.1% | 270 |
| Paperboards, Paper & Packaging | 26.7% | 28.8% | -210 | 25.5% | 120 |

Source: Company and Nirmal Bang Research

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Financials

| Profitability (Rs. In Cr) | FY11 | FY12 | FY13E | FY14E |
|-----------------------------|----------------|----------------|----------------|----------------|
| Y/E - March | | | | |
| Revenues - Net | 22279.1 | 26179.5 | 30166.0 | 35037.9 |
| % change | 16.4% | 17.5% | 15.2% | 16.2% |
| EBITDA | 7373.2 | 8837.5 | 10536.9 | 12485.4 |
| Interest | 70.9 | 80.5 | 84.2 | 91.7 |
| Other Income | 831.69 | 1156.62 | 1249.64 | 1301.71 |
| EBDT | 8134.0 | 9913.6 | 11702.3 | 13695.4 |
| Depreciation | 699.1 | 745.5 | 854.1 | 933.5 |
| Extraordinary/Exceptional | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 7434.9 | 9168.1 | 10848.2 | 12761.8 |
| Tax | 2365.5 | 2845.8 | 3579.9 | 4211.4 |
| PAT | 5069.4 | 6322.4 | 7268.3 | 8550.4 |
| Share of Profit & loss | 9.6 | 11.3 | 13.3 | 15.3 |
| Minority Interest in Income | 61.1 | 75.5 | 80.5 | 85.5 |
| Adj PAT | 5017.9 | 6258.1 | 7201.1 | 8480.2 |
| Shares o/s (No. in Cr.)* | 773.8 | 781.8 | 782.3 | 782.3 |
| EPS | 6.1 | 8.0 | 9.2 | 10.8 |
| Adj EPS* | 6.1 | 8.0 | 9.2 | 10.8 |
| Cash EPS | 7.5 | 9.0 | 10.4 | 12.1 |
| DPS (Rs.) | 4.5 | 4.5 | 5.5 | 7.0 |

| Quarterly (Rs. In Cr) | Dec.11 | Mar.12 | Jun.12 | Sep.12 |
|-------------------------------------|---------------|---------------|---------------|---------------|
| Net Revenue | 6280.0 | 6954.6 | 6713.1 | 7226.6 |
| EBITDA | 2384.6 | 2263.4 | 2368.3 | 2688.3 |
| Interest | 22.3 | 14.8 | 13.8 | 23.3 |
| EBDT | 2362.3 | 2248.5 | 2354.6 | 2665.0 |
| Dep | 173.9 | 188.0 | 194.8 | 188.9 |
| Other Income | 288.3 | 207.9 | 176.8 | 185.0 |
| Extraordinary | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 2476.7 | 2268.4 | 2336.6 | 2661.1 |
| Tax | 775.7 | 654.0 | 734.4 | 824.7 |
| PAT from ordinary activities | 1701.0 | 1614.4 | 1602.1 | 1836.4 |
| Minority Interest | 0.0 | 0.0 | 0.0 | 0.0 |
| PAT | 1701.0 | 1614.4 | 1602.1 | 1836.4 |
| EPS (Rs.) | 2.2 | 2.1 | 2.0 | 2.4 |

| Operational Ratio | FY11 | FY12 | FY13E | FY14E |
|------------------------|-------|-------|-------|-------|
| EBITDA margin (%) | 33.1% | 33.8% | 34.9% | 35.6% |
| Adj.PAT margin (%) | 22.5% | 23.9% | 23.9% | 24.2% |
| Adj.PAT Growth (%) | 20.4% | 24.7% | 15.1% | 17.8% |
| Price Earnings (x) | 45.9 | 37.2 | 32.3 | 27.4 |
| Book Value (Rs.) | 21.3 | 24.9 | 29.6 | 33.9 |
| ROCE (%) | 48.2% | 51.1% | 51.1% | 51.5% |
| RONW (%) | 32.4% | 34.8% | 33.8% | 34.2% |
| Debt Equity Ratio | 0.0 | 0.0 | 0.0 | 0.0 |
| Price / Book Value (x) | 14.0 | 12.0 | 10.1 | 8.8 |
| EV / Sales | 7.0 | 6.1 | 5.2 | 4.4 |
| EV / EBITDA | 27.2 | 22.4 | 18.9 | 15.9 |

| Balance Sheet (Rs. In Cr) | FY11 | FY12 | FY13E | FY14E |
|---------------------------|----------------|----------------|----------------|----------------|
| Share Capital | 773.8 | 781.8 | 782.3 | 782.3 |
| Preference Share Capital | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserves & Surplus | 15716.1 | 18676.7 | 22360.3 | 25706.3 |
| Net Worth | 16489.9 | 19458.6 | 23142.6 | 26488.6 |
| Minority Interest | 140.8 | 157.1 | 237.6 | 323.2 |
| Total Loans | 113.8 | 107.3 | 117.3 | 127.3 |
| Net Deferred Tax Assets | 798.1 | 865.8 | 865.8 | 865.8 |
| Total Liabilities | 17542.5 | 20588.7 | 24363.2 | 27804.8 |
| Net Fixed Assets | 10269.2 | 12089.8 | 13853.7 | 14437.7 |
| Investments | 4867.8 | 5206.8 | 5206.8 | 5206.8 |
| Goodwill in Consolidation | 270.4 | 314.1 | 314.1 | 314.1 |
| Other Assets | 96.3 | 131.6 | 151.3 | 175.8 |
| Inventories | 5734.8 | 6428.1 | 7799.1 | 9058.6 |
| Sundry Debtors | 1086.7 | 1203.8 | 1455.0 | 1690.0 |
| Cash & Bank | 2426.9 | 3130.1 | 5391.8 | 8225.2 |
| Loans & Advances | 1639.3 | 1559.1 | 1746.1 | 2028.0 |
| C A L&A | 10887.7 | 12321.2 | 16391.9 | 21001.9 |
| CL & P | 8848.9 | 9474.8 | 11554.7 | 13331.6 |
| Working Capital | 2038.8 | 2846.4 | 4837.2 | 7670.3 |
| Total Assets | 17542.5 | 20588.7 | 24363.2 | 27804.8 |

| Cash Flow (Rs. In Cr) | FY11 | FY12 | FY13E | FY13E |
|--|---------------|----------------|---------------|---------------|
| Operating | | | | |
| Profit Before Tax | 7434.9 | 9168.1 | 10848.2 | 12761.8 |
| Direct Taxes paid | -2365.5 | -2845.8 | -3579.9 | -4211.4 |
| Depreciation | 699.1 | 745.5 | 854.1 | 933.5 |
| Change in WC | -379.0 | -139.7 | 251.1 | -24.1 |
| Interest Expenses | 70.9 | 80.5 | 84.2 | 91.7 |
| Other Income | -814.2 | -1088.9 | -1249.6 | -1301.7 |
| CF from Operation | 4646.2 | 5919.8 | 7208.1 | 8249.8 |
| Investment | | | | |
| Capex | -951.8 | -2430.1 | -1801.2 | -1124.3 |
| Other Investment | 132.7 | -339.0 | 0.0 | 0.0 |
| Interest Received | 831.7 | 1156.6 | 1249.6 | 1301.7 |
| Total Investment | 12.6 | -1612.5 | -551.6 | 177.4 |
| Free Cash Flow | 4658.8 | 4307.3 | 6656.5 | 8427.2 |
| Financing | | | | |
| Equity raised/(repaid) | 0.0 | 0.0 | 0.0 | 0.0 |
| Inc/Dec in Reserves | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt raised/(repaid) | 3.0 | -6.5 | 10.0 | 10.0 |
| Dividend (incl. tax) paid | -3512.6 | -3517.1 | -4320.6 | -5512.1 |
| Deferred Revenue Exp. | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest Expenses | -70.9 | -80.5 | -84.2 | -91.7 |
| Cash Flow from Financing Activities | -3580.5 | -3604.1 | -4394.8 | -5593.8 |
| Net Cash Flow | 1078.3 | 703.3 | 2261.7 | 2833.4 |
| Beginning Cash Flow | 1348.6 | 2426.9 | 3130.1 | 5391.8 |
| Cash as reported in Balance Sheet | 2426.9 | 3130.1 | 5391.8 | 8225.2 |

Source: Company and Nirmal Bang Research

ITC Ltd.

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