

July 26, 2012

 Gautam Duggad
 gautamduggad@plindia.com
 +91-22-66322233

Rating	BUY
Price	Rs249
Target Price	Rs275
Implied Upside	10.4%
Sensex	16,640
Nifty	5,043

(Prices as on July 26, 2012)
Trading data

Market Cap. (Rs bn)	1,930.3
Shares o/s (m)	7,738.1
3M Avg. Daily value (Rs m)	1487

Major shareholders

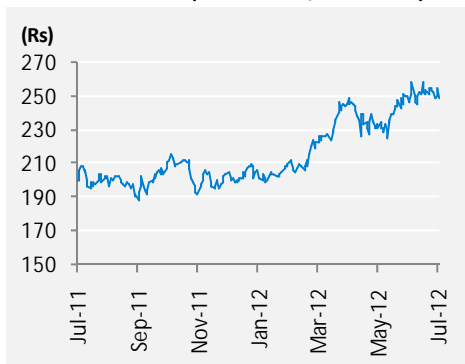
Promoters	0.00%
Foreign	17.73%
Domestic Inst.	34.14%
Public & Other	48.13%

Stock Performance

(%)	1M	6M	12M
Absolute	1.0	21.1	24.2
Relative	2.5	23.6	34.3

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	9.3	9.3	0.3
2014	11.2	10.9	2.3

Price Performance (RIC: ITC.BO, BB: ITC IN)


Source: Bloomberg

■ **Cigarettes volumes up ~1%:** ITC's Q1FY13 results met our expectations, with Sales, EBITDA and PAT at Rs66.5bn (16.5 % YoY), Rs23.07bn (23.2%YoY) and Rs16.02bn (20% YoY) v/s our expectations of Rs66.6bn, Rs22.1bn and Rs16.08bn, respectively. Cig volumes grew ~1% better than our expectations of ~2% decline. This is impressive, given the recent ~13% price increases taken post budget. Cig EBIT growth of 20.5% and margin expansion of 260bps once again underscores the pricing power enjoyed by ITC. Non-Cig FMCG sales grew by 23%, led by volumes and improved mix, while losses halved for the quarter. Hotels continued to post weak numbers with flat revenues and 50% EBIT decline driven by start-up costs for its Chennai property. Agri division posted revenue decline (-1%) on account of surplus leaf tobacco inventory and adverse commodity price comps. However, richer mix aided the 90bps margin expansion.

■ **FMCG losses decline 75%; Cig margins up 260bps:** Cigarette posted strong 260bps improvement in EBIT margins driven by price hikes, better product mix, softer RM costs and eighth consecutive quarter of margin expansion, underscoring ITC's pricing power once again. Non-Cig FMCG growth was driven by branded packaged food, personal care and stationery unit. Packaged Foods witnessed mixed improvement across segments, in turn, aiding improvement in profitability as losses reduced 49% to Rs388m. As per management, Sunfeast Yippee noodles continued to gain share. Paper division reported a modest 9% growth, constrained by capacity (capacity addition of 1lakh tons expected in Q4FY13e) but posted a strong 180bps YoY and 550bps QoQ margin expansion. Hotels performance was impacted by weak macros and increased supply.

■ **Maintain 'BUY' with a revised SOTP of Rs275:** We maintain our estimates for now despite better-than-expected Cig volumes and margins which enhances near-term earnings visibility for the stock. We are modelling 2% volume declines for FY13e. Continued traction in non-FMCG sales and improving profitability along with consistent and higher pay-out ratio are the other positives. ITC is also relatively well insulated from potential monsoon-related headwinds for the consumer sector. Performance of <65mm Cig is a key monitorable.

Key financials (Y/e March)

	2011	2012	2013E	2014E
Revenues (Rs m)	222,737	261,837	301,614	350,084
Growth (%)	16.4	17.6	15.2	16.1
EBITDA (Rs m)	74,077	88,415	101,816	121,237
PAT (Rs m)	50,083	62,584	72,891	87,182
EPS (Rs)	6.5	8.0	9.3	11.2
Growth (%)	20.3	23.7	16.5	19.6
Net DPS (Rs)	4.5	4.8	5.6	6.7

Profitability & Valuation

	2011	2012	2013E	2014E
EBITDA margin (%)	33.3	33.8	33.8	34.6
RoE (%)	32.4	35.8	37.2	39.6
RoCE (%)	32.5	36.0	37.2	39.6
EV / sales (x)	8.4	7.2	6.2	5.3
EV / EBITDA (x)	25.2	21.2	18.3	15.3
PE (x)	38.5	31.2	26.8	22.4
P / BV (x)	11.7	10.6	9.4	8.4
Net dividend yield (%)	1.8	1.9	2.2	2.7

Source: Company Data; PL Research

Exhibit 1: Q1FY13 Result Overview (Rs m)

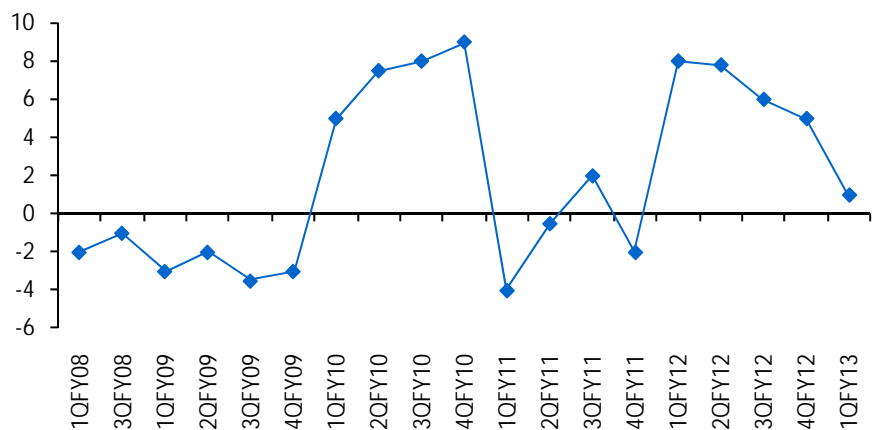
Y/e March	Q1FY13	Q1FY12	YoY gr. (%)	Q4FY12	FY13E	FY12	YoY gr. (%)
Net sales	66,522	57,675	15.3	68,614	301,614	261,795	15.2
(Increase) / decrease in stock-in-trade & WIP	(2,496)	(4,090)		3,124		(864)	
Consumption of raw materials	20,683	19,582		18,942		78,105	
Purchase of traded goods	7,579	7,609		5,975		19,212	
RM cost	25,766	23,101	11.5	28,041	109,615	96,453	
Gross profit	40,756	34,574	17.9	40,573	191,999	165,342	16.1
Employees cost	4,125	3,885	6.2	3,323	22,923	19,443	17.9
Other expenditure	13,557	11,960	13.3	15,549	67,260	57,525	16.9
EBITDA	23,075	18,729	23.2	21,701	101,816	88,375	15.2
Depreciation	(1,948)	(1,665)	17.0	(1,880)	(8,110)	(7,455)	
Other income	2,376	2,506	(5.2)	3,012	13,286	11,566	14.9
EBIT	23,503	19,571		22,832	106,992	92,487	15.7
Interest	(138)	(200)		(148)	(329)	(805)	
PBT	23,366	19,370	20.6	22,684	106,663	91,682	16.3
Tax	(7,344)	(6,043)		(6,540)	(33,129)	(28,458)	
PAT	16,021	13,327	20.2	16,144	73,534	62,581	17.5
RM cost	38.7	40.1		40.9	36.3	36.8	
Employee cost	6.2	6.7		4.8	7.6	7.4	
Other expenses	20.4	20.7		22.7	22.3	22.0	
EBITDA margins	34.7	32.5		31.6	33.8	33.8	
EBIT Margins	35.3	33.9		33.3	35.5	35.3	
PBT margins	35.1	33.6		33.1	35.4	35.0	
Tax rate	31.4	31.2		28.8	31.1	31.0	
PAT margins	24.1	23.1		23.5	24.4	23.9	

Source: Company Data, PL Research

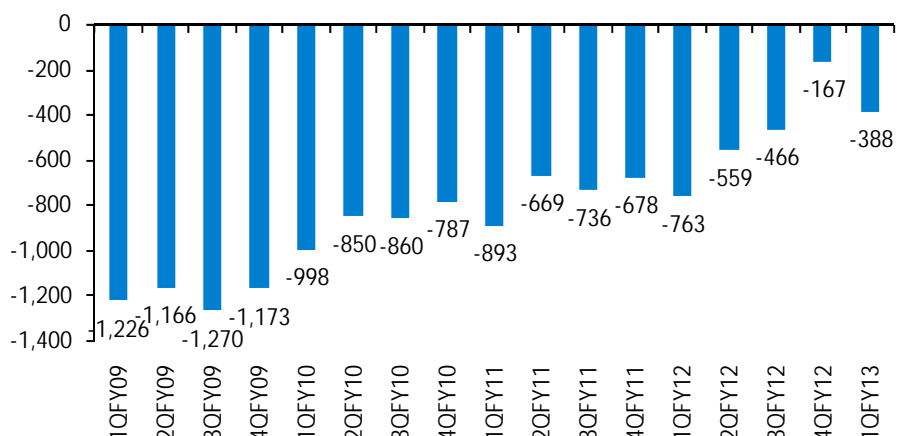
Exhibit 2: Segmental Break-up (Rs m)

Y/e March	Q1FY13	Q1FY12	YoY gr. (%)	Q4FY12	QoQ gr. (%)
Revenue					
Cigarettes	33,042	28,736	15.0	32,499	1.7
Other FMCG	14,731	11,978	23.0	16,165	(8.9)
Total FMCG	47,773	40,713	17.3	48,664	(1.8)
Hotels	2,324	2,305	0.8	2,858	(18.7)
Agri business	16,914	17,071	(0.9)	14,142	19.6
Paper and packaging	10,361	9,596	8.0	9,799	5.7
Total- other businesses	29,599	28,972	2.2	26,800	10.4
Total segment revenue	77,372	69,685	11.0	75,464	2.5
EBIT					
Cigarettes	18,998	15,767	20.5	17,579	8.1
Other FMCG	(388)	(763)	NA	(167)	NA
Total FMCG	18,610	15,004	24.0	17,412	6.9
Hotels	262	513	(48.9)	829	(68.4)
Agri business	1,714	1,571	9.1	1,056	62.3
Paper and packaging	2,647	2,270	16.6	1,958	35.2
Total- other businesses	4,623	4,354	6.2	3,842	20.3
Total EBIT	23,233	19,358	20.0	21,254	9.3
EBIT margins					
Cigarettes	57.5	54.9		54.1	
Other FMCG	(2.6)	(6.4)		(1.0)	
Total FMCG	39.0	36.9		35.8	
Hotels	11.3	22.3		29.0	
Agri business	10.1	9.2		7.5	
Paper and packaging	25.5	23.7		20.0	
Total- other businesses	15.6	15.0		14.3	
Total	30.0	27.8		28.2	

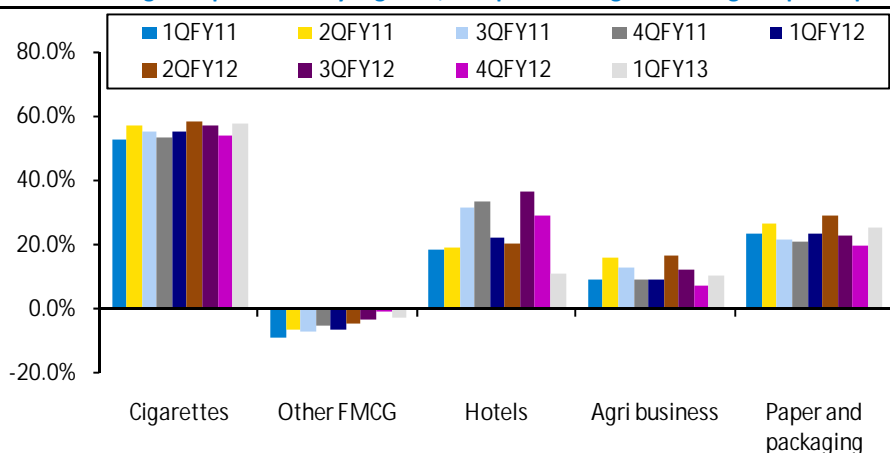
Source: Company Data, PL Research

Exhibit 1: Cig Volumes up ~1%; ahead of expectations


Source: Company Data, PL Research

Exhibit 2: Other FMCG losses decline 49% YoY


Source: Company Data, PL Research

Exhibit 3: Margins expand in every segment; except Hotels Cigarette margins up 260bps


Source: Company Data, PL Research

Exhibit 4: SOTP

	Multiple (EV/ EBITDA)	EBITDA (FY14E)	Contribution to value of ITC (Rs m)	(Rs/ share)
Cigarettes	17	91,530	1,610,924	206
FMCG-Others (EV/Sales)	2	77,392	185,741	24
Hotels	15	4,444	66,655	9
Agri business	8	7,548	60,384	8
Paper	8	16,080	128,637	16
Net (debt)/ cash			95,631	12
Total value per share			2,147,973	275

Source: PL Research

Income Statement (Rs m)

Y/e March	2011	2012	2013E	2014E
Net Revenue	222,737	261,837	301,614	350,084
Raw Material Expenses	81,184	96,455	109,615	127,323
Gross Profit	141,553	165,382	191,999	222,761
Employee Cost	17,240	19,441	22,923	25,906
Other Expenses	50,236	57,526	67,260	75,618
EBITDA	74,077	88,415	101,816	121,237
Depr. & Amortization	6,991	7,455	8,110	8,900
Net Interest	502	804	329	299
Other Income	7,765	11,556	13,286	15,361
Profit before Tax	74,349	91,712	106,663	127,399
Total Tax	23,655	28,486	33,129	39,574
Profit after Tax	50,694	63,227	73,534	87,825
Ex-Od items / Min. Int.	611	643	643	643
Adj. PAT	50,083	62,584	72,891	87,182
Avg. Shares O/S (m)	7,738.1	7,818.4	7,818.4	7,818.4
EPS (Rs.)	6.5	8.0	9.3	11.2

Cash Flow Abstract (Rs m)

Y/e March	2011	2012	2013E	2014E
C/F from Operations	44,897	54,119	66,992	80,200
C/F from Investing	(7,958)	(4,860)	(5,595)	(5,922)
C/F from Financing	(29,903)	(42,640)	(50,934)	(60,911)
Inc. / Dec. in Cash	7,036	6,619	10,463	13,367
Opening Cash	58,941	66,128	72,747	83,210
Closing Cash	66,128	72,747	83,210	96,577
FCFF	43,169	49,546	61,649	74,468
FCFE	43,308	49,446	61,549	74,368

Key Financial Metrics

Y/e March	2011	2012	2013E	2014E
Growth				
Revenue (%)	16.4	17.6	15.2	16.1
EBITDA (%)	17.1	19.4	15.2	19.1
PAT (%)	20.3	25.0	16.5	19.6
EPS (%)	20.3	23.7	16.5	19.6
Profitability				
EBITDA Margin (%)	33.3	33.8	33.8	34.6
PAT Margin (%)	22.5	23.9	24.2	24.9
RoCE (%)	32.5	36.0	37.2	39.6
RoE (%)	32.4	35.8	37.2	39.6
Balance Sheet				
Net Debt : Equity	(0.4)	(0.4)	(0.4)	(0.4)
Net Wrkng Cap. (days)	72	70	54	41
Valuation				
PER (x)	38.5	31.2	26.8	22.4
P / B (x)	11.7	10.6	9.4	8.4
EV / EBITDA (x)	25.2	21.2	18.3	15.3
EV / Sales (x)	8.4	7.2	6.2	5.3
Earnings Quality				
Eff. Tax Rate	31.8	31.1	31.1	31.1
Other Inc / PBT	10.4	12.6	12.5	12.1
Eff. Depr. Rate (%)	5.0	4.8	4.7	4.6
FCFE / PAT	86.5	79.0	84.4	85.3

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2011	2012	2013E	2014E
Shareholder's Funds	164,621	184,664	206,721	233,106
Total Debt	1,246	1,146	1,046	946
Other Liabilities	9,520	9,733	9,981	10,277
Total Liabilities	175,386	195,543	217,748	244,329
Net Fixed Assets	105,118	113,578	123,849	135,731
Goodwill	—	—	—	—
Investments	6,819	7,319	7,819	8,319
Net Current Assets	63,317	74,514	85,948	100,146
<i>Cash & Equivalents</i>	<i>66,128</i>	<i>72,747</i>	<i>83,210</i>	<i>96,577</i>
<i>Other Current Assets</i>	<i>85,357</i>	<i>101,543</i>	<i>117,690</i>	<i>135,227</i>
<i>Current Liabilities</i>	<i>88,168</i>	<i>99,777</i>	<i>114,952</i>	<i>131,658</i>
Other Assets	132	132	132	132
Total Assets	175,386	195,543	217,748	244,329

Quarterly Financials (Rs m)

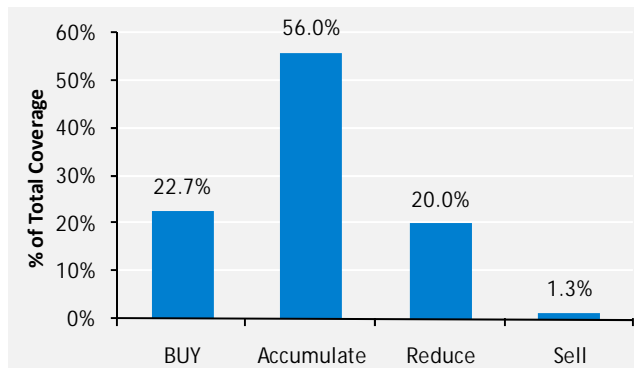
Y/e March	Q2FY12	Q3FY12	Q4FY12	Q1FY13
Net Revenue	59,742	61,954	68,614	66,522
EBITDA	21,080	23,000	21,701	23,075
<i>% of revenue</i>	<i>35.3</i>	<i>37.1</i>	<i>31.6</i>	<i>34.7</i>
Depr. & Amortization	1,701	1,739	1,880	1,948
Net Interest	142	223	148	138
Other Income	2,918	3,729	3,012	2,376
Profit before Tax	22,155	24,767	22,684	23,366
Total Tax	7,012	7,757	6,540	7,344
Profit after Tax	15,143	17,010	16,144	16,021
Adj. PAT	15,143	17,010	16,144	16,021

Key Operating Metrics

Y/e March	2011	2012	2013E	2014E
Cig Vol. Gr.	(2.8)	6.0	(2.0)	6.0
Cig Pricing Gr.	18.0	6.1	15.0	8.0
Cig EBIT Gr.	17.5	19.8	17.0	16.8
Other FMCG Rev. Gr.	23.0	23.4	18.1	18.1
Other FMCG Losses	(3,315)	(2,141)	(1,169)	1,072

Source: Company Data, PL Research.

Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

This document has been prepared by the Research Division of Prabhudas Lilladher Pvt. Ltd. Mumbai, India (PL) and is meant for use by the recipient only as information and is not for circulation. This document is not to be reported or copied or made available to others without prior permission of PL. It should not be considered or taken as an offer to sell or a solicitation to buy or sell any security.

The information contained in this report has been obtained from sources that are considered to be reliable. However, PL has not independently verified the accuracy or completeness of the same. Neither PL nor any of its affiliates, its directors or its employees accept any responsibility of whatsoever nature for the information, statements and opinion given, made available or expressed herein or for any omission therein.

Recipients of this report should be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The suitability or otherwise of any investments will depend upon the recipient's particular circumstances and, in case of doubt, advice should be sought from an independent expert/advisor.

Either PL or its affiliates or its directors or its employees or its representatives or its clients or their relatives may have position(s), make market, act as principal or engage in transactions of securities of companies referred to in this report and they may have used the research material prior to publication.

We may from time to time solicit or perform investment banking or other services for any company mentioned in this document.