## ITC - Buy
## Investment overview

- ITC is the biggest cigarette company of the country and leading FMCG marketer. It is the second largest Hotel chain, the market leader in the Indian Paperboard and Packaging industry and the country's foremost Agri business player
- ITC is setting up a new tobacco facility in Mysore, which is expected to go on stream from FY12. This would help in reducing logistics costs for procurement and exports.
- The company has entered into a pact with Northern Technologies International Corporation to jointly develop and commercialize biopolymer-paper products.
- Company's FMCG segment registered robust revenue growth of 23% for the fiscal and demonstrated improving profitability

## Business Overview

ITC, incorporated as Imperial Tobacco Company of India Limited is having a multi-business portfolio encompassing a wide range of businesses - Cigarettes & Tobacco, Hotels, Information Technology, Packaging, Paperboards & Specialty Papers, Agri-business, Foods, Lifestyle Retailing, Education & Stationery and Personal Care.

The company is more than 100 year old and its first six decades of existence were primarily devoted to the growth and consolidation of the Cigarettes and Leaf Tobacco businesses. However, seventies witnessed the beginnings of a corporate transformation that ushered in momentous changes in the life of the Company. ITC is the market leader in cigarettes in India. With its wide range of invaluable brands, it has a leadership position in every segment of the market.

Almost a decade ago the company made its entry into the branded & packaged Foods business and the company is having products in almost all the categories of the business. Apart from the current portfolio of products, several new and innovative products are under development in ITC's state-of-the-art Product Development facility located at Bengaluru.

ITC's Lifestyle Retailing Business Division has established a nationwide retailing presence through its Wills Lifestyle chain of exclusive specialty stores.

In line with ITC's aspiration to be India's premier FMCG company, recognised for its world-class quality and enduring consumer trust, ITC forayed into the Personal Care business in July 2005. ITC's Personal Care portfolio comes under the 'Essenza Di Wills', 'Fiama Di Wills', 'Vivel Di Wills' 'Vivel UltraPro', 'Vivel' and 'Superia' brands.

ITC is India's leading corporates in the agricultural sector enduring farmer partnerships that has revolutionized and transformed the rural agricultural sector. ITC's Agri Business Division is the country's second largest exporter of agri-products with exports of over Rs 1000 Crores (Rs. 10 billion).

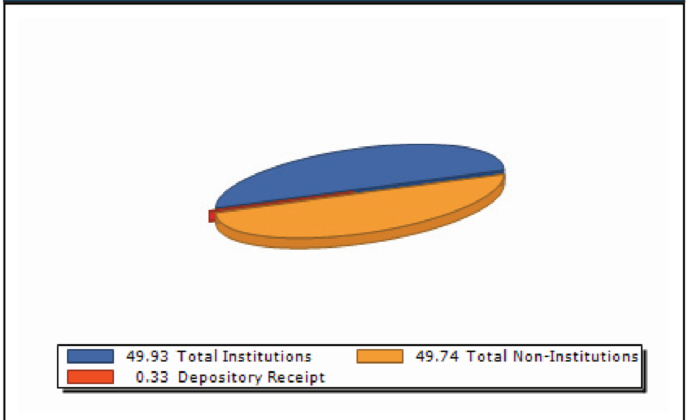
ITC Hotels brand has become synonymous with Indian hospitality. With over 100 hotels in more than 90 destinations.

ITC is also having its presence in the Information Technology. ITC Infotech has today carved a niche for itself in the arena of global IT services and solutions. The company services industries including, Banking Financial Services & Insurance (BFSI), Consumer Packaged Goods (CPG), Retail, Manufacturing, Engineering Services, Media & Entertainment, Travel, Hospitality, Life Sciences and Transportation & Logistics.

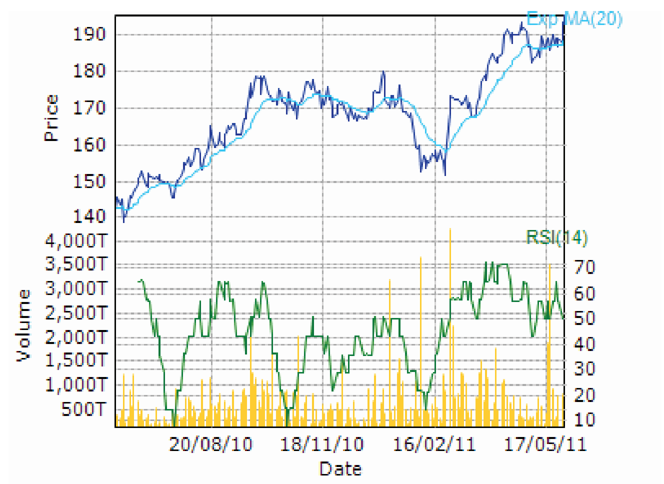
### Financial Health

| Stock Data | 15/06/11 |
|---|---|
| Current Mkt Price (Rs) | 194.00 |
| 52 Week High | 197.75 |
| 52 Week Low | 138.05 |
| Mkt Cap (Rs. in Cr.) | 149965.20 |
| Return in last one Month (%) | 4.25 |

### Share Holding




### Performance in last one year




### Y-o-Y Performance

(Rs. in Million)

| Particulars | Mar 2010 | Mar 2009 | Change(%) |
|---|---|---|---|
| Net Sales | 18153.19 | 15611.92 | 16.28 |
| Other Income | 623.02 | 544.99 | 14.32 |
| Total Expenditure | 12061.91 | 10734.11 | 12.37 |
| Operating Profit | 6714.30 | 5422.80 | 23.82 |
| Interest | 90.28 | 47.65 | 89.46 |
| Profits After Tax | 4061.00 | 3263.59 | 24.43 |
| Reserve & Surplus | 0.00 | 0.00 | 2.43 |
| Reported EPS(Rs) | 10.64 | 8.65 | 23.01 |
| Core EBITDA Margin (%) | 23.20 | 21.08 | 10.06 |

ITC posted yet another stellar performance for the year ended March 31,2011, Net sales were up by 16.93% to Rs 31423.23 crore from Rs 26874.34 crore in last year. Net profit of the company stood at Rs 4987.61 crore, up by 22.82% from Rs 4061.00 crore in the year ago period. Net Turnover was at Rs 21167.58 crores up by 17% primarily driven by a 23% growth in the non-cigarette FMCG businesses, 23% growth in Agri business and 18% growth in the Hotels segment.

For the fourth quarter, net Sales were up by 15.48% to Rs 5836.26 crore from Rs 5053.79 crore in same quarter last year, while the net profit zoomed by 24.63% to Rs 1281.48 crore from Rs 1028.22 in corresponding previous quarter. Net Turnover stood at Rs 5836.26 crores registering a growth of 15% driven by robust performance in Hotels, non-cigarette FMCG businesses and the Paperboard, Paper and Packaging segment.

Hotels business posted robust performance with revenues and profits growing by 18% and 23% respectively. Paper and Pulp Segment results grew by 20% for the year.

## Industry Scenario

India is the second- largest producer of tobacco in the world after China. However, it holds a meagre 0.7 per cent share of the $30-billion global trade in tobacco. Tobacco is one of the important cash crops in the country, and makes a significant contribution to the Indian economy in terms of employment, income and government revenue. Of the total tobacco produced in the country, around 48 per cent is consumed in the form of chewing tobacco, 38 per cent as bidis, and 14 per cent as cigarettes. Cigarettes account for 85 per cent of the country's total tobacco exports.

A wide variety of tobaccos are grown in 16 states in India under diverse agroclimatic conditions. However, most of the varieties grown (other than Virginia, Burley and Oriental) are of non-cigarette types. These include natu, bidi, chewing, hooka (hookah), cigar and cheroot tobaccos and account for about 77 percent of the total output (Table 4.2). Cultivation of FCV tobacco was initially confined to the traditional black soil areas of Andhra Pradesh. However, to suit the quality requirements in internal and export markets, cultivation of FCV was encouraged in light soils in Karnataka and Andhra Pradesh. In the initial years, the varieties grown were limited to Havana tobacco used in cigars, and Lanka tobacco used in the manufacture of snuff and bidis. Subsequently, other forms, like FCV, were introduced.

Tobacco in India, as in many other countries, yields higher net returns per unit of land than most other cash crops, and substantially more than food crops. Currently, there are a few specialized crops in various areas that provide similar incomes, but it is estimated that these crops would not remain remunerative if total production increased. The economics of alternative crops is generally based on experiments carried out on a limited area at research stations under optimal conditions. More detailed research work is needed on a wider scale at farmers' field level before firm recommendations can be made about them. In general, under farmers' field conditions, most other alternative crops, as discussed below, are currently not as remunerative as tobacco. Should tobacco farmers need to diversify into other crops, they are likely to suffer economic hardship.

These alternative crops also require high levels of irrigation. Tobacco is preferred due to its drought resistance and suitability for growing under rainfed conditions.Other problems

### Q-o-Q Performance

(Rs. in Million)

| Particulars | Mar 2011 | Mar 2010 | Change(%) |
|---|---|---|---|
| Net Sales | 596.00 | 513.61 | 16.14 |
| Expenditure | 404.72 | 351.37 | 15.18 |
| Other Income | 10.22 | 5.92 | 72.57 |
| EBITDA | 201.50 | 167.72 | 20.14 |
| Interest | 1.40 | 1.85 | -24.31 |
| Net Profit | 128.15 | 102.82 | 24.63 |
| EBITDA Margin (%) | 0.34 | 0.33 | 3.44 |
| NPM (%) | 0.22 | 0.20 | 7.31 |
| EPS | 1.66 | 2.71 | -38.75 |

### Profit & Loss

(Rs. in Million)

| Particulars | Mar 2010 | Mar 2009 | Change(%) |
|---|---|---|---|
| Net Sales | 18153.19 | 15611.92 | 16.28 |
| Total Income | 18776.21 | 16156.91 | 16.21 |
| Total Expenditure | 12061.91 | 10734.11 | 12.37 |
| Operating Profit | 6714.30 | 5422.80 | 23.82 |
| Profits After Tax | 4061.00 | 3263.59 | 24.43 |

### Balance Sheet

(Rs. in Million)

| Particulars | Mar 2010 | Mar 2009 | Change(%) |
|---|---|---|---|
| Share Capital | 381.82 | 377.44 | 1.16 |
| Reserve & Surplus | 13682.56 | 13357.64 | 2.43 |
| Total Liabilities | 14172.09 | 13912.63 | 1.86 |
| Investments | 5726.87 | 2837.75 | 101.81 |
| Current Liabilities | 3498.30 | 2974.12 | 17.62 |
| Net Current Assets | 78.84 | 3456.10 | -97.72 |
| Total Assests | 14172.09 | 13912.63 | 1.86 |

### Key Ratios

| Particulars | Mar 2010 | Mar 2009 |
|---|---|---|
| Reported EPS (Rs) | 10.64 | 8.65 |
| Core EBITDA Margin (%) | 23.20 | 21.08 |
| EBIT Margin (%) | 23.25 | 21.06 |
| ROA (%) | 28.92 | 24.93 |
| ROE (%) | 29.33 | 25.42 |
| ROCE (%) | 43.65 | 37.38 |
| Price/Book (x) | 7.17 | 5.10 |
| Net Sales Growth (%) | 16.28 | 11.93 |
| EBIT Growth (%) | 25.28 | 5.72 |
| PAT Growth (%) | 24.43 | 4.60 |
| Total Debt/Mcap (%) | 0.00 | 0.01 |

associated with substitution by other crops include the capital invested in specialized facilities created for tobacco processing, which cannot be used for other crops; the difficulties of finding substitute crops for rainfed areas; and the dependency of millions of people on bidi rolling and tendu leaf collection. Moreover, with an assured market and prompt payment of sale proceeds through the Tobacco Board, it will be difficult to replace FCV tobacco as a crop.

Even though tobacco comes under state jurisdiction, the Government of India plays an important role in the growth and development of the tobacco industry. In fact, at least six ministries of the Union Government - Agriculture, Commerce, Finance, Industry, Labour, and Rural Development - deal with one or another specified aspects of the industry. Following the increasing health concern about tobacco consumption, the central Ministry of Agriculture has not launched any development scheme for the crop since the completion of the Seventh Five-Year Plan (1985-90). However, in general, government policy has been to promote production, improve quality and ensure remunerative prices for growers.

A shift away from the tobacco crop would be likely to reduce the demand for hired labour in most states, as the hired labour required for alternative crops is substantially lower. Total labour requirements for alternative crops, including family labour, would be some 35 percent lower.

### Investment Rationale

ITC has been able to build on its leadership position because of its single minded focus on value creation for the consumer through significant investments in product design, innovation, manufacturing technology, quality, marketing and distribution. The company has recorded an impressive topline growth and high quality earnings for the FY11, reflecting the robustness of its corporate strategy of creating multiple drivers of growth. The non-cigarette FMCG business reported robust growth in FY11 (net sales up 23.1%), led by good performance by all its segments like Branded Packaged Foods, Personal Care and Education & Paper Stationery, while the Agri business profits were up 26% for the year.

The revenue in the Hotel business of the company was up by 17.2% to Rs 300.33 crores in Q4FY11. Construction activities of the new super luxury properties at Chennai and Kolkata are progressing satisfactorily. The Chennai property is expected to be operational in Q1-Q2FY12 and would add 600 rooms. ITC Gardenia, launched last year, has rapidly established itself as the premier hotel in Bengaluru and delivered profits in its first full year of operations. The hotel business is likely to gain momentum on account of increasing domestic & foreign tourism, gradual improvement in ARRs & occupancy levels and strong macro economic conditions.

The paper and pulp business of the company has shown a good growth of 20% in the passing fiscal and going further the company has entered into a pact with Northern Technologies International Corporation to jointly develop and commercialize biopolymer-paper products. The two companies will jointly developing solutions in the Indian market towards providing biodegradable/compostable products such as food service ware, food packaging, personal care product packaging and other fast-moving consumer goods packaging. The biopolymer materials will be manufactured by Harita-NTI, NTIC's Indian joint venture, for integration with paper manufactured by ITC's Paperboards and Specialty Papers Division (PSPD). Both companies will also collaboratively develop and promote joint branding and messaging for these products. The existing market for flexible packaging in India is estimated at about $2.8 billion and is expected to grow by at least 14-15% annually for the foreseeable future with the rapidly increasing demand for consumer packaged goods. On the domestic front too the company is setting up a state-of-the-art plant which is expected to be operational by mid CY 2012. Hence, this collective development is likely to help the company in long run.

The company's IT unit, ITC Infotech after the inclusion of SAP Business ByDesign subscription and implementation services, now offers its small and medium enterprise customers custom made, fully integrated business management software solutions delivered on-demand, which enable the benefits of large-scale business applications without the need of supporting the corresponding large IT-infrastructure. It has recently announced the launch of a new and differentiated offering for the CPG Industry - Siebel Innovation Pack for Trade Promotion Management (TPM), in partnership with Oracle. The Siebel Innovation Pack for Trade Promotion Management empowers CPG companies with highly flexible & intelligent solutions. Furthermore, ITC Infotech now offers implementation and consulting support for this new product to ensure rapid deployment entailing CPG industry best practices.

The non-cigarette FMCG business which contributes close to 50 per cent to the company's turnover, reported robust growth in FY11 (net sales up 23.1%), led by good performance by all its segments like Branded Packaged Foods, Personal Care and Education & Paper Stationery. The packaged foods business is an ideal avenue to leverage ITC's proven strengths in the areas of hospitality and branded cuisine, contemporary packaging and sourcing of agricultural commodities. The business sustained its impressive growth in the Soaps category, achieving a volume market share of 6%. The company was able to mitigate the impact of a steep increase in input costs through a combination of smart sourcing, increased internal efficiencies and cost saving actions across the supply chain.

At the CMP of Rs 194, ITC is trading at a P/E multiple of 30.06x and 25.20x FY12 (E), we recommend 'BUY' in the scrip with a price target of Rs 233. All businesses in the ITC portfolio are mandated to engage with overseas markets with a view to testing and demonstrating international competitiveness and seeking profitable opportunities for growth. Though the main cigarette business is likely to remain under pressure due to continued discriminatory taxation, restrictive regulation and hardening competitive pressures, abut as it has diverted its concentration on other business it won't be of much worry. Also it is setting up a new tobacco facility in Mysore, which is expected to go on stream from FY12. This would help in reducing logistics costs for procurement and exports.