

**ITC Ltd: Still Smoking hot.....**

*Continues to deliver better numbers despite tough regulatory environment;*

India's largest Cigarette maker ITC Ltd posted 3<sup>rd</sup> Quarter numbers better than Street consensus, with 20.4% (YoY) of sales growth led by better growth across all segments and 21.4% of PAT growth.

Company saw its Cigarette revenue (contributes half of its revenue) growth by 13.1% (YoY), backed by the price hike in Gold Flake brand. Company reported 31.3% growth on FMCG business which include biscuits and crisps, and soaps and shampoos, (contributes 24% of sales), 43% on Agri Products (contributes 21% of sales), and 9% on Paper& Packaging (contributes 14% of sales) on YoY basis. While, ITC's hotels business, however, remains slow, amid the overall slowdown in the industry. Hotel business sales fell 11%.

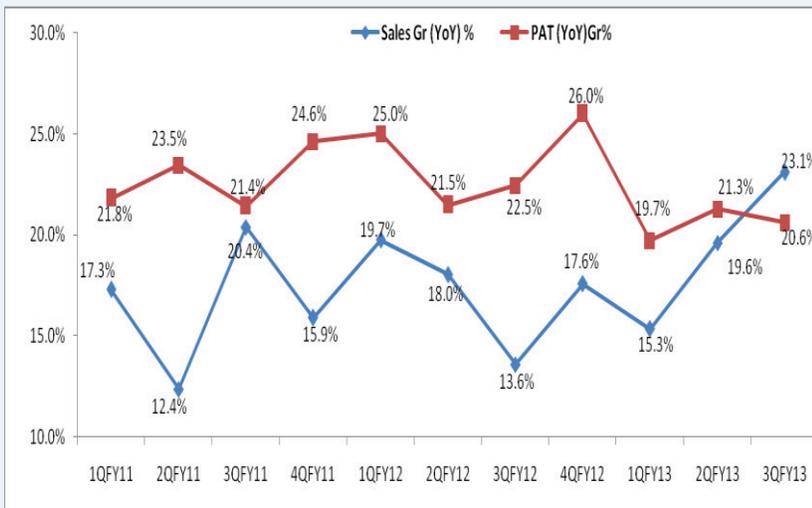
Company's EBITDA Margin was flat at 37.8% on YoY basis, but increased by 490bps sequentially. On segmental EBIT Margin, ITC registered 400bps margin growth to 61% on Cigarette, Agri Business and Paper Product Business margin down by 100bps to 22% and 11% respectively.

The high tax on Cigarettes has created arbitrage opportunities leading to the growth of illegal cigarettes in the country. Consequently, Company has reported volume growth on Cigarettes by 2-3% after marginal increase of 0.4 in the previous quarter. The non-cigarette business has shown a good jump. This is a good sign because the company has been focusing heavily on diversification.

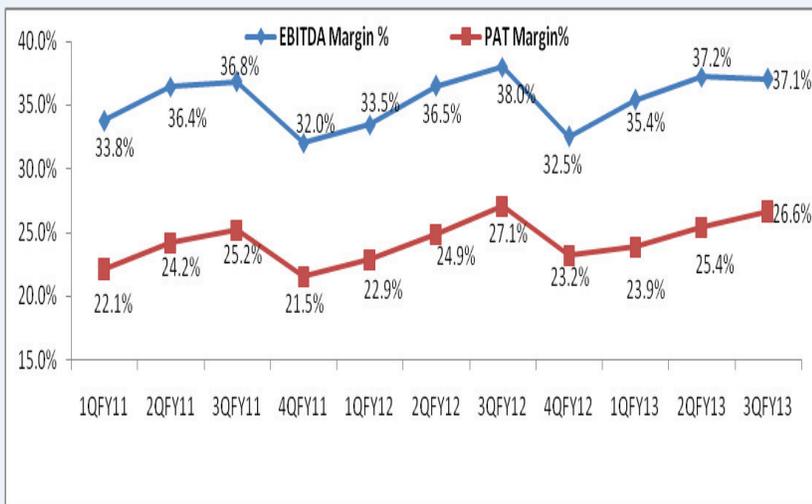
ITC continues to enjoy dominant market share in cigarette while flat rate in excise duties has provided a strong pricing power. While, we expect a steep hike in excise duties on Cigarettes in the wake of government's efforts to contain fiscal deficit at the time of Union Budget (FY13-14) session. On segmental revenue, Paper Product businesses have achieved self-sustenance levels with regular and ongoing paper business. New launches in Soap, body wash, fairness cream (Vivel Active Fairness) and Noodles(Bingo) have received good response.

20 states and Union Territories have already announced ban on Gutkha (most popular form of chewing tobacco in India with about 100mn users nationwide). The ban is in force in all these states except Uttar Pradesh where ban will come into effect on April 1, 2013. We believe this will be a positive for the cigarette industry. Same time, demand of 64mm category of Cigarettes is on the sky. Consumers are shifting their taste from Gutkha to same price of 64mm Cigarettes.

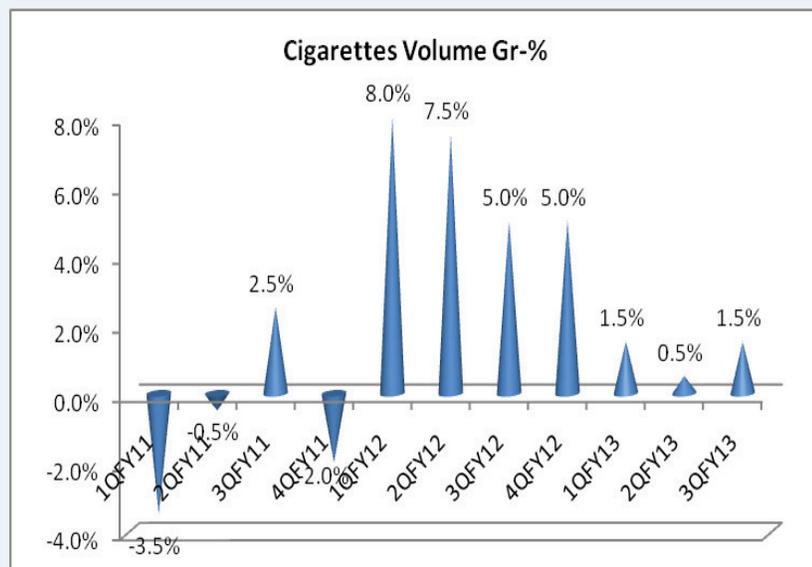
Company has entered the high growth instant noodles market with Sunfeast Yippies brand, while it has also planned addition of 1,500 rooms in the coming 3-4 years (almost 50% of existing capacity) to its hotel business. We are positive on long-term demand growth in cigarette business due to rising affordability and huge demand potential in small towns and rural areas. At the CMP of Rs 287, the stock trades at PE of 26x FY14E EPS. We maintain "BUY" with a price target of Rs 320. However, in the near term, the overhang of likely excise duty hikes in FY13-14 budget session might prevail.



(Source: Company/Eastwind)



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