

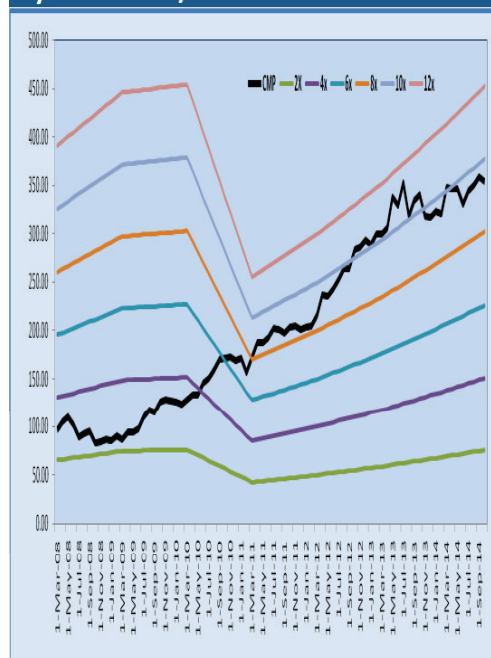
Result update	BUY
CMP	355
Target Price	420
Previous Target Price	380
Upside	18%
Change from Previous	11%

Market Data	
BSE Code	500875
NSE Symbol	ITC
52wk Range H/L	387/307
Mkt Capital (Rs Cr)	284090
Average Daily Volume	3497040
Nifty	8463

Stock Performance			
	1M	1yr	YTD
Absolute	1.5	15.4	38.3
Rel. to Nifty	-4.1	-25.8	8.3

Share Holding Pattern-%			
	Current	1QFY15	4QFY14
Promoters	-	-	-
FII	20.3	19.2	19.3
DII	34.8	35.0	34.7
Others	44.9	45.8	46.0

1 yr Forward P/B



The health ministry has accepted proposals of an expert panel to ban the sales of loose cigarettes.

The expert panel constituted by the Health Ministry pointed out 3 key recommendations. (1) Prohibition of single or loose cigarettes (2) Increasing the minimum legal age for sale of tobacco products and (3) Increasing the fine or penalty amount for violation of certain provisions of the cigarettes and other tobacco products act.

The Ministry has accepted the recommendations and a draft note for Cabinet has been circulated for consultation.

Further, with ITC being the market leader in cigarettes, trend of healthy rise in profits amid volume growth pressure is likely to continue through this financial year. Considering government's recent expected regulatory action and health cautious decision against the smoking, we expect flattish to negative cigarettes volume growth in FY15E.

If this recommendation is accepted, this will be adverse for Cigarette Industry for earning and sentiment Prospects. The sale of loose cigarettes in India contributes 70% of the cigarette volumes. Therefore, the volume of Cigarette sale will decline because of ban on loose Cigarette.

We believe, this will not be easy to implement of such regulation in India. 7-8 million outlets will have to be regulated very frequently and effectively and India is not having appropriate infrastructure to do that.

No impact on Margin: Despite tougher environment for implementation, if it implements, it will be negative for volume growth. However, they will retain its margin by price hike in near future.

Volume growth, a subject of concern: This was the 6th consecutive quarter when the company's cigarettes volume fell. Because of increased prices of cigarette, volume growth declined by 4-4.5% YoY. We expect, volume growth pressure is likely to continue through this financial year.

Products strategy: ITC continues to enjoy dominant market share in cigarette while ban on Gutkha by most of state govt- has provided a strong demand especially on 64mm size. ITC is set to foray into the dairy segment with value-added products like ghee and milk powder being the preliminary offerings.

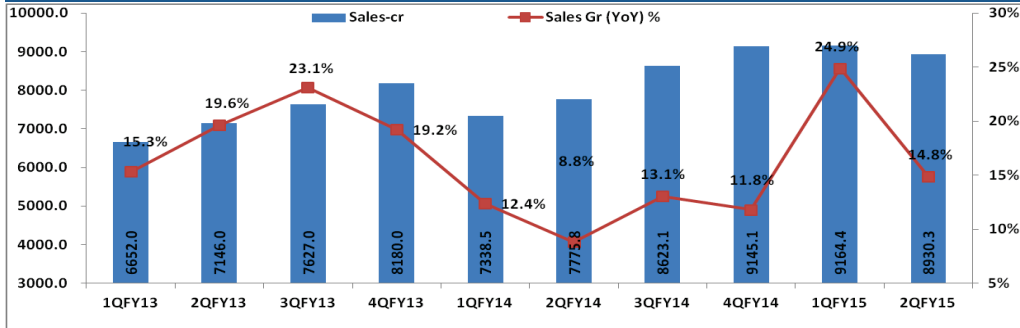
View and Valuation: ITC's cigarette volume growth could be flattish to negative in FY15E, while non-cigarette business could perform healthy. We are positive on long-term demand growth in cigarette business due to huge demand potential in small towns and rural areas. **ITC offers the best earnings visibility in the sector and enjoying premium valuations. At the CMP of Rs 355, the stock trades at 8.9x/7.6x FY15E/FY16E P/BV seems justified from a growth point of view. We maintain "BUY" view with a price target of Rs 420.**

Financials

	2QFY15	1QFY15	(QoQ)-%	2QFY14	(YoY)-%
Revenue	8930.32	9164.42	-2.6%	7775.79	14.8%
EBITDA	3488.7	3277.6	6.4%	3173.3	9.9%
PAT	2425.3	2184.4	11.0%	2227.98	8.9%
EBITDA Margin	39.1%	35.8%	(330bps)	40.8%	(170bps)
PAT Margin	27.2%	23.8%	340bps	28.7%	(150bps)

ITC

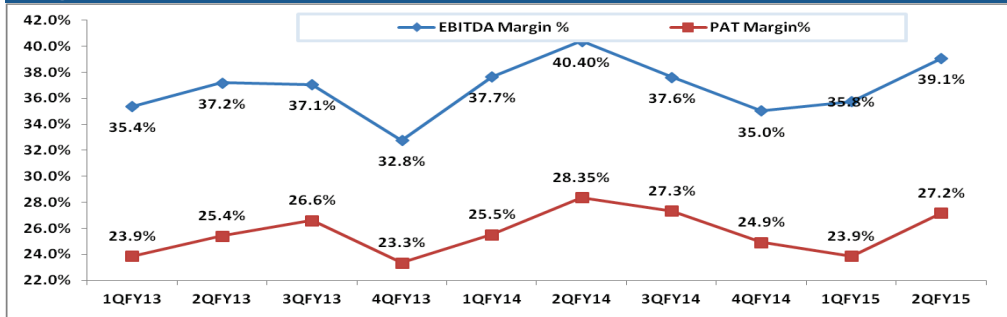
Sales and its Growth(%)



(Source: Company/Eastwind)

Cigarette sales have grown by 14.8% YoY. However, ITC attributed its performance to the strategy of creating multiple drivers of growth.

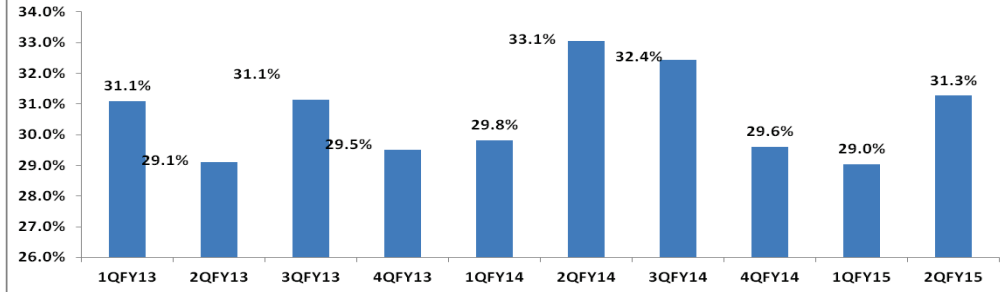
Margin-%



(Source: Company/Eastwind)

These cost pressures were, however, mitigated through a combination of improvements in product and process efficiencies, smart sourcing and supply chain initiatives.

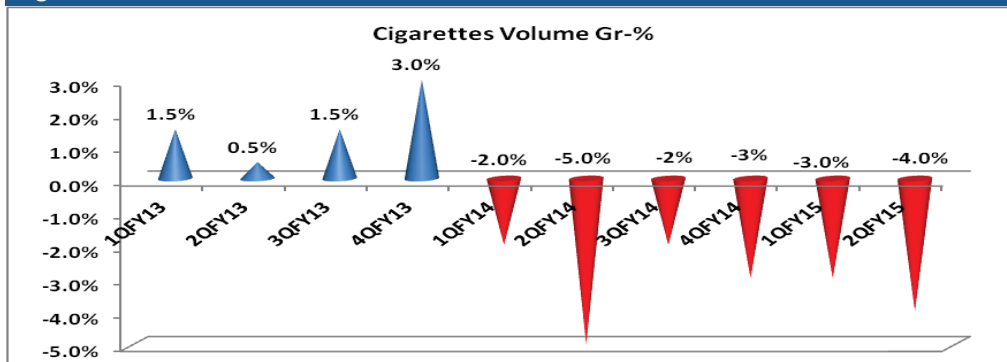
RM Cost%



(Source: Company/Eastwind)

RM Cost soft by 180bps to 31.3%

Cigarette Volume Growth-%



(Source: Company/Eastwind)

ITC clocks 4% volume decline in cigarettes, A nearly 40% duty hike on normal-sized cigarettes in the past 2 years - introduced by a cash-strapped government keen to boost tax revenue - along with a sharp drop in discretionary spending is gradually pushing up sales of the ITC 64 mm cigarettes.

ITC

Segment-wise Performance-%

Segments	Sales Contribution	Sales Gr-YoY	EBIT Margin	Margin Change(YoY)
Cigarettes	47.6%	14.2%	67.8%	300bps
FMCG - Others	24.6%	11.7%	-0.5%	(157bps)
Hotels	2.9%	5.9%	-3.7%	(30bps)
Agri business	23.1%	16.1%	14.5%	(160bps)
Paper and packaging	14.4%	8.9%	18.9%	20bps

Double digit growth in Cigarette, FMCG, and Paper & Packaging, but single digit growth on Hotel and Agri business

Financials

Rs in Cr,	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
Sales	19302.1	22575.0	26552.2	31627.5	35317.1	41263.12	46673.48
RM Cost	6045.5	7136.9	7810.5	9069.8	10376.1	12378.94	13768.68
Purchases of stock-in-trade	826.0	1296.8	1921.2	3305.2	3305.2	3920.00	4293.96
WIP	100.5	(273)	(86)	(257)	(113)	(413)	(233)
Employee Cost	1464.0	1708.5	1944.3	2145.6	2504.2	3094.73	3500.51
Ad Spend	544.9	654.6	710.1	834.2	0.0	1114.10	1260.18
Other expenses	3830.9	4381.9	5042.4	5355.1	6520.7	6395.78	7467.76
Total expenses	12811.8	14905.9	17342.0	20453.2	22593.4	26490.92	30057.72
EBITDA	6490.3	7669.1	9210.1	11174.3	12723.6	14772.20	16615.76
Depreciation and Amortisation	643.9	699.1	745.5	859.1	964.9	990.31	1120.16
Other Income	452.7	536.1	784.3	877.6	971.0	1134.74	1306.86
EBIT	6299.1	7506.1	9249.0	11192.8	12729.7	14916.62	16802.45
Interest	53.4	70.9	80.5	87.2	6.4	61.56	66.56
PBT	6245.7	7435.2	9168.5	11105.7	12723.3	14855.05	16735.89
Tax Exp	2034.9	2365.5	2845.8	3412.1	4360.9	4902.17	5439.16
PAT	4210.8	5069.7	6322.7	7693.6	8362.4	9952.89	11296.73

Growth-% (YoY)

Sales	15.7%	17.0%	17.6%	19.1%	11.7%	16.8%	13.1%
EBITDA	24.7%	18.2%	20.1%	21.3%	13.9%	16.1%	12.5%
PAT	25.4%	20.4%	24.7%	21.7%	8.7%	19.0%	13.5%

Expenses on Sales-%

RM Cost	31.3%	31.6%	29.4%	28.7%	29.4%	30.0%	29.5%
Ad Spend	2.8%	2.9%	2.7%	2.6%	0.0%	2.7%	2.7%
Employee Cost	7.6%	7.6%	7.3%	6.8%	7.1%	7.5%	7.5%
Other expenses	19.8%	19.4%	19.0%	16.9%	18.5%	15.5%	16.0%
Tax rate	32.6%	31.8%	31.0%	30.7%	34.3%	33.0%	32.5%

Margin-%

EBITDA	33.6%	34.0%	34.7%	35.3%	36.0%	35.8%	35.6%
EBIT	32.6%	33.2%	34.8%	35.4%	36.0%	36.2%	36.0%
PAT	21.8%	22.5%	23.8%	24.3%	23.7%	24.1%	24.2%

Valuation:

CMP	263.2	181.5	256.5	335.0	325.0	355.00	355.00
No of Share	381.8	773.8	779.6	790.2	790.2	790.18	790.18
NW	14458.3	16489.9	19458.6	23157.9	27237.0	31643.16	36930.98
EPS	11.0	6.6	8.1	9.7	10.6	12.60	14.30
BVPS	37.9	21.3	25.0	29.3	34.5	40.05	46.74
RoE-%	29.1%	30.7%	32.5%	33.2%	30.7%	31.5%	30.6%
P/BV	6.9	8.5	10.3	11.4	9.4	8.86	7.60
P/E	23.9	27.7	31.6	34.4	30.7	28.18	24.83

(Source: Company/Eastwind)