

Investment idea for 2014

Investor’s Delight: ITC Ltd. “BUY”

ITC has robust portfolio of traditional and greenfield businesses encompassing Fast Moving Consumer Goods (FMCG), Hotels, Paperboards & Specialty Papers, Packaging, Agri-Business, and Information Technology. Today ITC is the country’s leading FMCG marketer, the clear market leader in the Indian Paperboard and Packaging industry, a globally acknowledged pioneer in farmer empowerment through its wide-reaching Agri Business, the second. Within a relatively short span of time, ITC has established vital brands like Aashirvaad, Sunfeast, Dark Fantasy, Delishus, Bingol, Yippee!, Candyman, mint-o, Kitchens of India in the Branded Foods space; Essenza Di Wills, Fiamma Di Wills, Vivel, Vivel Cell Renew, Engage and Superia in the Personal Care products segment; Classmate and Paperkraft in Education & Stationery products; Wills Lifestyle and John Players in the Lifestyle Apparel business; Mangaldeep in Agarbattis and Aim in the Safety Matches segment. This growth has been rated by a Nielsen Report to be the fastest among the consumer goods companies operating in India. For years now, ITCs tobacco business has been like a roaring volcano spewing up cash which has funded its diversifications. The leadership of its cigarette brands provides the basis for the cash flows that are enabling the creation of world – class Indian brands in multiple segments. They are also the basis for building the capital intensive hotels and paperboards business.

New FMCG business driving growth..

ITCs growing new FMCG business has started contributing significantly to the Company’s growth. ITC plans to shake-up distribution of fast-moving consumer goods by rolling out its entire range of packaged food and personal care products through lakhs of paan shops across India, taking advantage of relationships it has built up with paanwallahs over the years through the cigarette business. As part of the initiative, ITC is sprucing up the outlets and training the paanwallahs to sell soaps, biscuits and noodles. Directly servicing the paan shops over decades has allowed ITC to forge close ties with them. The strategy is in sharp contrast with that of rivals, which mostly sell confectionery, snacks and at best sachets of shampoos and detergent through paan shops. ITC, on the other hand, even plans to sell its premium cookies and cream biscuits through them. It will offer Sunfeast biscuits, Yippee instant noodles, Vivel soaps, Mangaldeep agarbattis, Dark Fantasy Choco Fills and Choco Meltz biscuits, Delishus cookies and Engage deodorants through these outlets, known to the trade as the paanplus channel. In FY13, new FMCG business net sales accounted for Rs. 7,028 crores, 16 percent of the Company’s gross revenues from operations and grew at 27 percent that year. In the last 5 years, the business has witnessed at an impressive CAGR of 22.73 percent. ITC’s FMCG products are sold in more than 60 lakh outlets across the country. This campaign has given ITC a big lead in the paanplus channel, especially over peers such as market leader HUL, which has a much bigger advantage in its reach through neighbourhood stores. Being a relatively new entrant, it is still some years before ITC can build kirana store access like HUL. It is here the paan shops can boost ITC’s market share.

Strong Financial Performance..

The Company’s net sales grew more than six fold from Rs. 5,230 crore in FY02 to Rs. 31,627 crore in FY13. On the other hand PAT witnessed a 6x jump from Rs. 1,162 crore to Rs. 7,608 crore in FY13.

CMP	Rs. 323
Target Price	Rs. 462
Upside	43%
Beta vs Sensex	0.78
BSE/NSE Code	500875/ITC
Bloomberg Code	ITC:IN
52 Week High	Rs. 380 (24th July, 2013)
52 Week Low	Rs. 272.2 (11 th Jan, 2013)
Face Value	Rs. 2
Share Capital	Rs. 7.9 bn
Market Capitalization	Rs. 2,552 bn
Shareholding Pattern (%)	As on Sep. 2013
Financial Institutions	53.63
FII	19.30
DII	34.33
Non Institutions	46.08
Bodies Corporate	4.67
Custodians	0.29

Q2FY14 result update..

ITC Ltd has reported 21.46 per cent increase in net profit at Rs 2,230.53 crore for the second quarter ended September 30, driven by a strong performance in the FMCG business.

It had reported net profit of Rs 1,836.42 crore in the July-September quarter of the previous fiscal 2012-13. Its net sales during Q2, 2013-14 increased by 8.81 per cent to Rs 7,775.79 crore from Rs 7,146 crore in the year-ago period, ITC said in a filing to the BSE. The company's Q2 revenue from FMCG business increased by 12.01 per cent to Rs 5,686.03 crore against Rs 5,075.95 crore in the second-quarter of last fiscal. ITC's FMCG business is divided into two categories – cigarettes and others. Revenue from cigarettes increased by 10 per cent to Rs 3,723.81 crore, while 'others' category showed an increase of 16.05 per cent at Rs 1,962.22 crore. Others in FMCG business include packaged foods (bakery and confectionery foods, snack foods, staples, spices and ready-to-eat foods), apparel, education and stationery products, personal care products, safety matches and incense sticks. Revenue from non-FMCG business, which includes hotels, agriculture and paperboard, paper and packaging, were at Rs. 3,198.17 crore, a decrease of 3.08 per cent.

Outlook and Valuation..

With due consideration to factors like a) leadership in cigarette brands (103 year history in tobacco business), b) robust return ratios (ROCE: 52.6% and ROE: 36.28%), c) new FMCG business growing at a rapid pace and contributing significantly to overall business, d) quality management, we recommend a "BUY". At CMP, the stock trades at a PE multiple of 33x at 12 month (TTM) EPS of Rs. 9.69. We value the stock at 35x FY15 estimated EPS of Rs. 13.19 by street to arrive at a target price of Rs. 462 for investors with a 12 months horizon.

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For research related queries contact:

Mr. Akash Jain – Vice President (Research) at research@ajcon.net

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Corporate and Broking Division: 408 - (4th Floor), Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall and Patel's, Western Express Highway, Malad (East), Mumbai – 400063. Tel: 91-22-67160421

Registered Office: 101, Samarth, Off. Hinduja Hospital, 151 Lt. P.N. Kotnis Road, Mahim (West), Mumbai – 400016. Tel: 022-24460335/36/40