



TM

### ITC

27 July 2023

#### ROCE to see sharp jump post long-awaited hotel demerger

ITC management has proposed the long-awaited demerger of its hotel business into a new separately listed entity. Under the demerger scheme, ITC would hold a stake of 40% and the balance 60% will be held by company's shareholders proportionate to their shareholding in the company. The hotel business has been a cash-guzzler for ITC contributing only about 4% to revenue and 3% to ITC's EBITDA in FY23 with 22% contribution to its capital employed resulting in single-digit ROCEs. With the new company now becoming an associate company for ITC, it would drive a significant 18-20% jump in ROCE and ~10% jump in ROIC for the company. The transaction is expected to be tax-neutral with stamp duty cost not having a material bearing on the transaction. A royalty structure will be worked out based on relevant industry benchmarks at a later date.

While a 100% mirror demerger would have been better for shareholders in our view, the management believes that there are significant synergy benefits that all stakeholders can derive with ITC being the controlling shareholder in addition to offering the flexibility and stability required for future growth aspirations in the hotels business. This transaction would create India's second largest hotel entity with a cash-rich balance sheet and options to enter strategic partnerships in its growth pursuits. This can lead to some holding company discount which investors might ascribe to ITC's stake in the hotels entity which was not the case currently, while there could also be some supply from existing shareholders like BAT on listing, which will remain an overhang. This is not a precedent for future corporate actions for other ITC businesses in our view, as the optimum structure for each business will be separately evaluated on the basis of its integration and shareholder value creation potential. We see this as a neutral event for ITC shareholders and would await the quarter results before revising our estimates and view on the stock.

#### ITC Hotels Overview

ITC Hotels currently has over 120 hotels and 11,600 keys across 70+ locations. Prior to 2004, ownership of Hotels business was split between ITC Ltd and ITC Hotels Ltd and its subsidiaries. ITC Hotels (separate listed entity) & Ansal Hotel Ltd was merged with ITC Ltd. Wef. 1<sup>st</sup> April, 2004. In 2018, ITC Hotels pivoted to an Asset Right strategy by focusing on taking up hotels on management contract basis to ensure that the company remains competitive and contemporary and continues to deliver superior performance.

#### Hospitality Industry poised for strong growth

Tourism industry in India is growing exponentially due to increasing global attention towards India and favorable Government policies. However, the hotel room supply in India is low. Over the next 5 years, demand for hotel rooms is expected to grow at 7% CAGR compared to supply growing at just 5% CAGR.

#### COMPANY UPDATE

**Sector:** FMCG **Rating:** BUY  
**CMP:** Rs 465 **Target Price:** Rs 474

#### Stock Info

Sensex/Nifty	66,266/ 19,660
Bloomberg	ITC IN
Equity shares (mn)	12439
52-wk High/Low	Rs 499/ 300
Face value	Rs 1
M-Cap	Rs 5787bn/US\$ 70bn
3-m Avg volume	US\$ 55mn

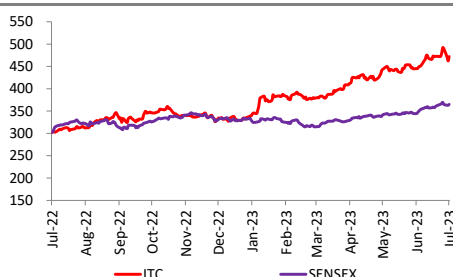
#### Financial Snapshot (Rs mn)

Y/E Mar	FY23	FY24E	FY25E
Sales	709,369	774,858	848,281
PAT	193,549	213,209	235,529
EPS (Rs)	15.6	17.2	19.0
PE (x)	29.9	27.1	24.5
EV/EBITDA (x)	22.3	20.2	18.2
P/BV (x)	8.3	8.1	7.8
EV/Sales	8.1	7.4	6.8
RoE (%)	29.4	30.4	32.5
RoCE (%)	39.0	40.3	43.2
NWC (days)	52	60	61
Net gearing (x)	0.0	0.0	0.0

#### Shareholding pattern (%)

	Jun23	Mar23	Dec22
Promoter	-	-	-
-Pledged	-	-	-
FII	43.6	43.4	43.0
DII	41.9	42.1	42.2
Others	14.5	14.6	14.8

#### Stock Performance (1-year)



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### Demerger transaction summary

ITC shareholders will hold about 60% direct stake in the Hotels Co. (proportionate to their stake in ITC); remaining about 40% stake will continue to be with ITC. The proposed restructuring would pave the way for the hotel business to operate as a separate entity in the rapidly expanding hospitality industry, focusing on its growth path with an optimal capital structure. This strategic move aims to ensure the company's continued interest in the hospitality sector, providing long term stability and support to the new entity for accelerated growth and sustained value creation. The demerger will help the new entity in attracting appropriate investors and strategic partners/ collaborations whose investment strategies and risk profiles are aligned more sharply with the hospitality industry. In addition, it will unlock value of the hotel business for the company's shareholders by providing them a direct stake in the new entity along with an independent market-driven valuation thereof. Assets, liabilities, contracts and employees forming part of the Hotel business are intended to be transferred to the Hotels Company. ITC Hotels will be given a license to use the 'ITC' name as part of its corporate name & some of its properties' names, subject to customary conditions.

### Q&A Takeaways

**ITC Hotels to be classified as an associate** - The transfer of ITC Hotels into a separate company where ITC will have 40% stake will be classified as an associate in the consolidated balance sheet.

**Asset Right strategy to continue** - Strategic positioning on future expansion will continue to be asset right going forward as well – focused on management contracts.

**Financial structure of ITC Hotels** - The new company will have strong balance sheet with no debt and asset worth few thousand crores. Management believes the company will be well equipped to raise capital. Mostly it will be asset light with less capital. Capital employed in hotel business is c. Rs 6000 crore in net assets.

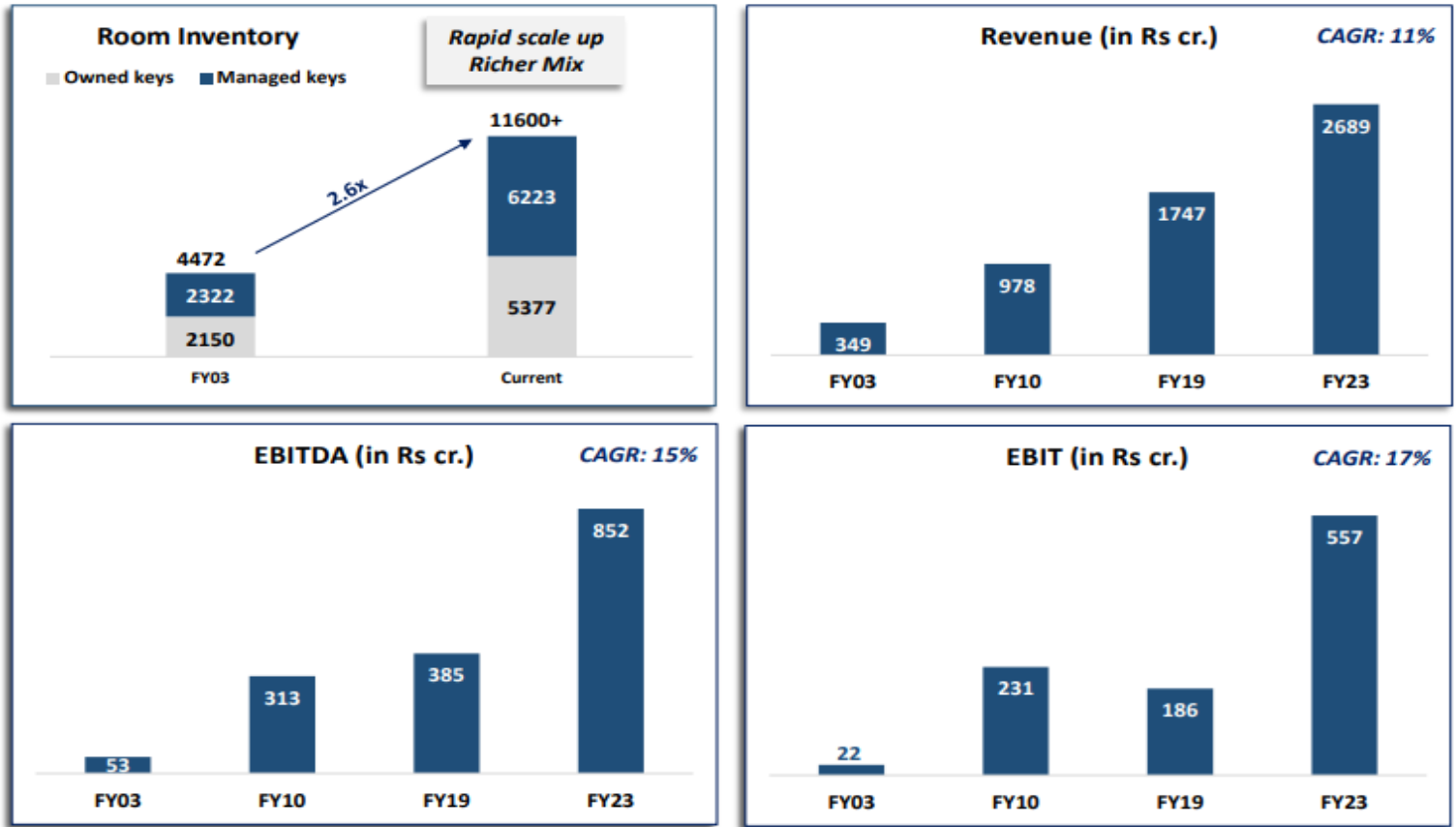
**Impact on financial ratios** - Financial ratios are expected to improve substantially. Since the new entity will be folded as an associate, it will move out of the segment capital employed i.e 20% comprising of hotels business will be moved out. Segment ROCE will improve by 18-20%. ROIC is also expected to improve in double digits by c. 10%. (based on FY23 numbers)

**Royalty and Tax implications** - For usage of ITC and brand assets there would be some royalty and it would be as per industry standards. Synergies will continue however will be on arm's length basis. As per the company, the demerger fulfills all tax conditions, so it's going to be a tax neutral situation.

**Issue of talent shifting from ITC to ITC Hotels** - The fact that new entity will continue to have the strategic support from ITC will continue to give support to employees. The values and the culture of the organization will continue. There is mobility of managers across divisions in ITC and that is the opportunity provided to high potential employees—where similar skills may be needed. ITC does have a stock option scheme for a section of employees. Once the employees are transferred, the new company would determine the terms of the scheme, the benefits that accrue to employees moving to hotels will be in no way inferior to that of ITC.

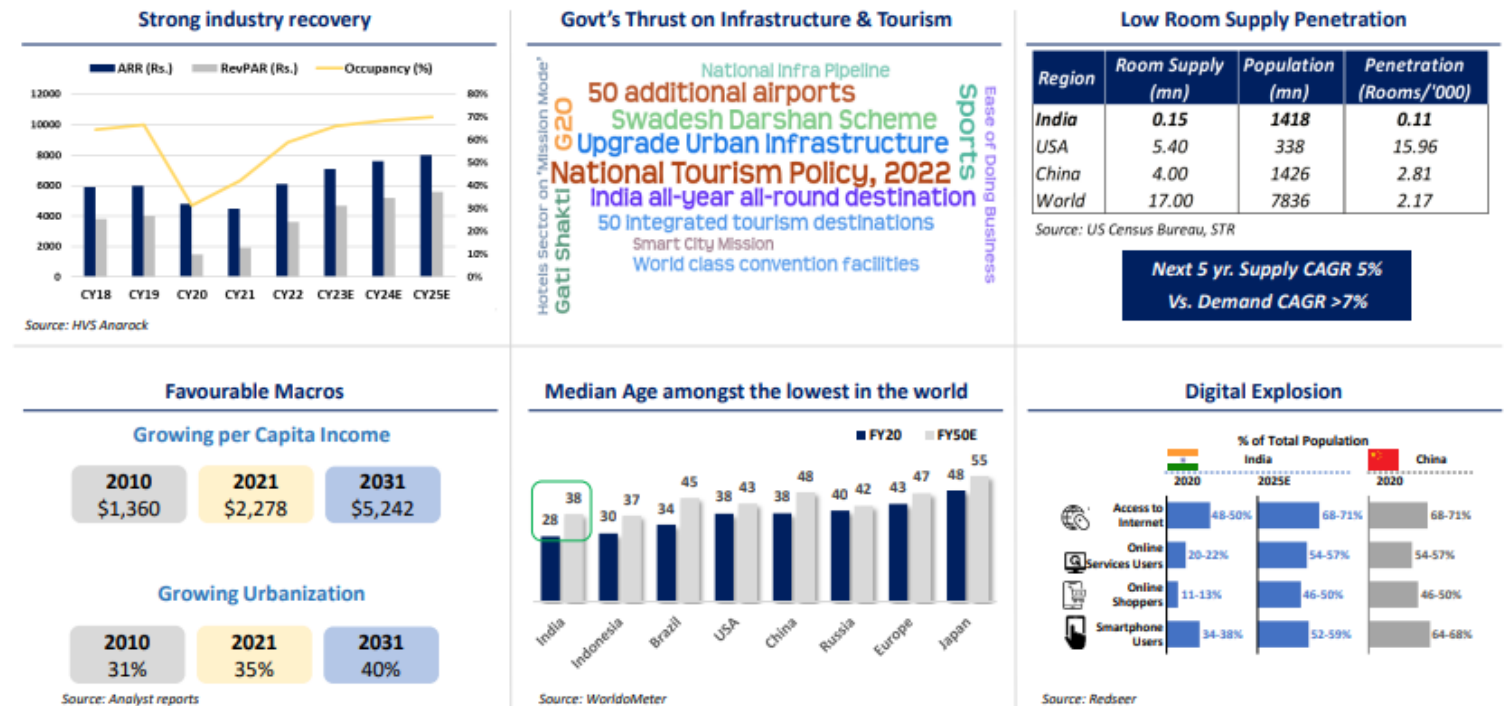
**Benefits from the new structure** - The structure is designed to reward the existing shareholders more than new shareholders. The new entity is expected to thrive in a much faster way as it will be given the brand value, goodwill, stability, and comfort to stakeholders & employees. Hence this structure will help to grow in a pure play method.

Exhibit 1: Rapid scale up of Hotels business post merger in 2004



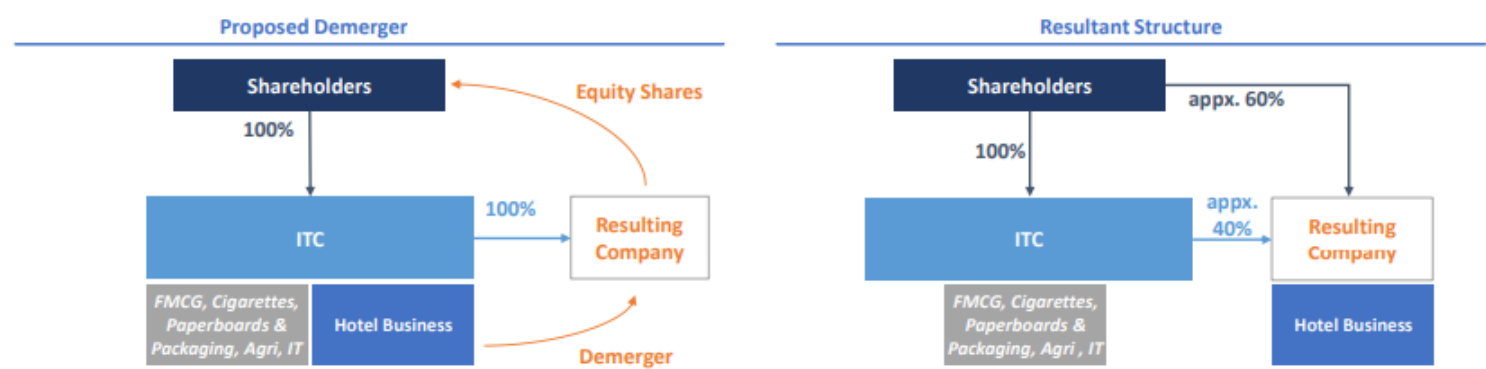
Source: Company, Systematix Institutional Research

Exhibit 2: Hospitality industry poised for strong growth ahead



Source: Company, Systematix Institutional Research

Exhibit 3: Existing ITC shareholders will hold 100% of Hotels Co.; 60% directly and balance of about 40% through their shareholding in ITC



Source: Company, Systematix Institutional Research

# FINANCIALS

## Profit & Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
<b>Revenue</b>	<b>4,92,728</b>	<b>6,06,681</b>	<b>7,09,369</b>	<b>7,74,858</b>	<b>8,48,281</b>
Gross profit	2,91,413	3,42,830	4,19,311	4,61,816	5,09,817
GP margin (%)	59.1%	56.5%	59.1%	59.6%	60.1%
<b>Operating profit</b>	<b>1,70,027</b>	<b>2,06,584</b>	<b>2,56,649</b>	<b>2,84,943</b>	<b>3,15,336</b>
OP margin (%)	34.5%	34.1%	36.2%	36.8%	37.2%
Depreciation	16,456	17,324	18,090	21,006	22,656
Interest expense	446	394	432	454	476
Other income	26,326	18,364	19,805	20,795	21,835
Profit before tax	1,79,451	2,07,230	2,57,932	2,84,279	3,14,039
Taxes	45,553	52,373	64,384	71,070	78,510
Tax rate (%)	25.4%	25.3%	25.0%	25.0%	25.0%
<b>Adj. PAT</b>	<b>1,31,612</b>	<b>1,52,427</b>	<b>1,93,549</b>	<b>2,13,209</b>	<b>2,35,529</b>
Exceptional loss	69	-	(729)	-	-
Net profit	1,31,543	1,52,427	1,94,277	2,13,209	2,35,529
<b>EPS</b>	<b>10.7</b>	<b>12.4</b>	<b>15.6</b>	<b>17.2</b>	<b>19.0</b>

Source: Company, Systematix Institutional Research

## Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Equity capital	12,309	12,323	12,428	12,428	12,428
Reserves	5,91,165	6,12,232	6,79,125	7,00,445	7,23,998
Debt	95	56	388	388	388
Minority Int	3,468	3,663	3,835	3,835	3,835
Deffered tax Liab	16,779	16,099	15,770	15,770	15,770
Other non current liabilities	6,935	5,957	9,723	10,209	10,719
<b>Total liabilities</b>	<b>6,30,750</b>	<b>6,50,331</b>	<b>7,21,269</b>	<b>7,43,076</b>	<b>7,67,139</b>
Fixed Asset	2,59,560	2,62,258	2,76,274	2,85,268	2,92,613
Investments	2,52,474	2,52,052	2,97,673	2,97,673	2,97,673
Other Non-current Assets	24,117	37,968	59,982	62,981	66,130
<b>Inventories</b>	<b>1,03,972</b>	<b>1,08,642</b>	<b>1,17,712</b>	<b>1,37,988</b>	<b>1,53,388</b>
Sundry debtors	25,017	24,619	29,562	42,458	48,805
<b>Cash &amp; equivalents</b>	<b>46,590</b>	<b>46,544</b>	<b>48,802</b>	<b>36,508</b>	<b>43,285</b>
Loans and Advances	25,878	39,877	28,305	29,858	33,684
Sundry creditors	43,187	44,173	46,590	53,072	60,425
Other current liabilities	63,671	77,457	90,451	96,586	1,08,015
<b>Total Assets</b>	<b>6,30,750</b>	<b>6,50,331</b>	<b>7,21,269</b>	<b>7,43,076</b>	<b>7,67,138</b>

Source: Company, Systematix Institutional Research

## Cash Flow

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
PBIT	1,79,897	2,07,624	2,58,364	2,84,732	3,14,515
Depreciation	16,456	17,324	18,090	21,006	22,656
Tax paid	(45,553)	(52,373)	(64,384)	(71,070)	(78,510)
Working capital Δ	30,225	22,321	(36,716)	(22,108)	(6,791)
Other operating items	-	-	-	-	-
<b>Operating cashflow</b>	<b>1,81,025</b>	<b>1,94,895</b>	<b>1,75,355</b>	<b>2,12,561</b>	<b>2,51,870</b>
Capital expenditure	(39,843)	(20,022)	(32,106)	(30,000)	(30,001)
<b>Free cash flow</b>	<b>1,41,181</b>	<b>1,74,873</b>	<b>1,43,249</b>	<b>1,82,561</b>	<b>2,21,869</b>
Equity raised	(48,482)	10,374	65,354	0	0
Investments	6,993	(25,398)	4,065	-	-
Debt financing/disposal	21	(39)	332	-	-
Interest Paid	(446)	(394)	(432)	(454)	(476)
Dividends paid	(1,32,320)	(1,41,718)	(1,92,634)	(1,91,888)	(2,11,976)
Other items	6,869	(17,745)	(17,676)	(2,513)	(2,639)
<b>Net Δ in cash</b>	<b>(26,183)</b>	<b>(46)</b>	<b>2,258</b>	<b>(12,294)</b>	<b>6,778</b>

Source: Company, Systematix Institutional Research

## Ratios

YE: Mar	FY21	FY22	FY23	FY24E	FY25E
Revenue growth (%)	-0.3	23.1	16.9	9.2	9.5
Op profit growth (%)	-11.7	21.5	24.2	11.0	10.7
Net profit growth (%)	-16.3	15.8	27.0	10.2	10.5
OPM (%)	34.5	34.1	36.2	36.8	37.2
Net profit margin (%)	26.7	25.1	27.3	27.5	27.8
RoCE (%)	28.5	33.6	39.0	40.3	43.2
RoNW (%)	21.0	24.8	29.4	30.4	32.5
EPS (Rs)	10.7	12.4	15.6	17.2	19.0
DPS (Rs)	10.8	11.5	15.5	15.4	17.1
BVPS (Rs)	49.3	51.0	56.0	57.7	59.6
Debtor days	19	15	15	20	21
Inventory days	77	65	61	65	66
Creditor days	32	27	24	25	26
P/E (x)	43.5	37.6	29.9	27.1	24.5
P/B (x)	9.4	9.1	8.3	8.1	7.8
EV/EBITDA (x)	33.4	27.5	22.3	20.2	18.2

Source: Company, Systematix Institutional Research

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