

We are deriving far more value by being together than being separate: ITC

‘The largest stimulus that can happen is actually getting back to work.’

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Sustainability, digital and respect for kirana to continue post Covid, says Sanjiv Puri, Chairman & MD.



What is your understanding of the new normal? Instead of using words like unprecedented crisis, how should we focus on opportunity?

Well, we have to live with a new normal. The reality is that this whole problem is not going away soon. We have to run our businesses and carry on with life and economic activity, taking all the safety precautions.

While there are challenges in this current situation because of the impact on the economic activity and certain sectors are very sharply impacted, we do see a fair amount of opportunities for us, particularly in our FMCG businesses. There is a lot of opportunity in the health, wellness, nutrition and hygiene space. Consumers are going to look for trusted brands and these are opportunities. Possible opportunities may emerge over time, on account of the geopolitical situation also. One example was the German shoemaker intending to set pace in outsourcing from Agra. So, there are going to be opportunities for sure and it is for us to be watchful and agile and make the best of the opportunities that fit into our capabilities and strategies.

What is your take on the government package which has been announced in the short term for an economy like India? Some would argue that India is a consumption driven economy and very little has been done to stimulate in the short term. But in the medium term, things have been done. So long haul or short haul or nothing?

In terms of the package that is required, if one wants to look at it in order of priority, I would say we need to reach out to the most vulnerable section of the society on priority and that has happened right at the beginning and it is continuing to do so.

It is heartening to see a lot of civil society members and corporates coming out in a big way to support the most vulnerable sections of society because this is a serious challenge for millions of people who earn their livelihood daily. That is most important. We must all remember that ultimately businesses do not flourish in societies that are under distress or tension. It is in our interest to support that. So, that is the most important.

The second is that the largest stimulus that can happen is actually getting back to work and how to adjust to the new normal. The longer we take to adjusting to the new normal, the bigger is the amount of stress and the

larger amount of resources will be required to pull it out. In order to get back to the new normal and get back economic activity in the new normal, first the government has to tackle the issues of liquidity and that is a first step.

We hope that going forward, we will see some measures to boost consumption. Some of the reforms that have been done for agriculture consists of moves that have been spoken about in the past and they can have a transformative impact on the agriculture sector over a period of time. But yes, those measures are not going to give impact immediately but medium term, these augur well for the economy.

In ITC, what has been your experience in terms of change of demand, impact of lockdown on FMCG and the tobacco/cigarette industry now that the lockdown has been lifted? How much of your business and capacities are back on track?

As far as FMCG is concerned, it is slowly getting back to normal demand levels. It varies across categories. We are seeing good demand for staples pieces that can be classified as discretionary.

Yes there is some amount of stress there but at an aggregate level, as far as foods and personal care is concerned, at an aggregate level, it is coming back to a reasonable level. Over time, as capacities scale up and as distribution improves and logistics improves further and markets fully open up, there is opportunity to go up further. There are segments like education and stationery which have been severely impacted for the moment because the sessions of the schools have changed and the business is heavily indexed to the school sessions. But ultimately, children will have to go back to school and students will have to go through education. I would say that it is more a timing issue than anything else.

On the other extreme, we have hotels which are very adversely impacted. Also hotels are supporting quarantine facilities or dealing with helping some stranded guests. Most of our hotels are not operational right now. This is in line with the guidelines of the government. Then we have agriculture also. It is slowly getting back to normal and this is indexed to food consumption, paper and paper board consumption. Somewhere, a little bit is still lagging because once the economy fully opens up, we will hopefully see more demand for paper boards and packaging coming in.

As a result of this crisis, do you think the Indian consumer psyche will change?

I believe that some of the trends that were already active pre-Covid, will accentuate post Covid crisis. For example, we had already become aware of the challenge of sustainability. Civil society was witnessing numerous extreme weather events over time. We were experiencing the shortages of water in cities also. Post Covid, people have seen how nature has healed itself. So, I think civil society and consumers are going to demand from everybody and every enterprise demonstrates behaviour that nourishes the environment.

We have for the first time seen what the environment should be. So, that is one trend. The second is I do see consumers looking for trusted brands, consumers putting a lot of attention and resources behind sanitation, health, hygiene, nutrition. The trend towards organics will accentuate.

Digital was an undercurrent earlier. It was on a fast trajectory. It is going to go up even more sharply and digital is going to become an even greater piece of our lives -- be it for management or for backend supply chain or consumer engagement or even consumers in their day to day activities.

I also see that the neighbourhood shop kirana is going to be in focus and get a lot of respect considering that that proved to be very critical in these difficult times. Of course, online transactions will continue to grow as things normalise because at least for sometime people may prefer to step out in a more limited sense and will realise the convenience of online.

Let me take the clock back 20 years ago ITC was just a tobacco company and a hotel company then. ITC moved into FMCG and they started diversifying and began the paper business. Today, based on your FY19 numbers, about 50% of your sales is now coming from the non-cigarette business. Five years down the line, how do you think things will change for ITC?

10 years back, it was 60% tobacco and 40% non-tobacco. Today it is actually the other way around. It is about 60% non-tobacco. It is not that we are shrinking tobacco, it is just that the investments we are making today. The headroom for growth is much higher in our other segments. So, we expect other segments to grow much

faster and certainly the figure will go more and more in favour of our non-tobacco businesses.

Today 80% of my capital employed is in non-tobacco businesses, 90% of my employees are not in non-tobacco businesses that reflect the kind of investments we are making in the non-tobacco segments. In all these segments, I believe there is huge headroom to grow notwithstanding that there are certain challenges in the short term, particularly with respect to the hospitality segment. Going forward, once we are over this difficult phase, even that segment offers opportunities because there is a lot of outbound tourism from India. I suspect as a trend, there will be even greater focus for inbound tourism.

Our approach in hotels so far has been to build a footprint which is largely done. There are some projects that are work in progress and our focus right now is on asset right strategy. Given the positioning we have, we will be able to expand our footprint quite a lot even in those segments besides FMCG over a period of time.

What is your outlook on the tobacco business?

The biggest challenge that the tobacco segment faces in India is the threat of the illegal segment. One in four cigarettes in India is an illicit cigarette and as taxes have been rising, the illicit industry has been rising. Over a period of five-six years, the taxes on cigarettes tripled and at a CAGR level, the tax rate grew at about over 15% whereas the revenue growth was between 4% and 5%.

There was stability in 2018-19 and revenues grew at about 9%. It was simply because the legal industry was able to claw back over a period of time. I see that as the biggest challenge as far as the cigarette industry is concerned and the data point that is available will hopefully convince and will be taken on board. We will see if there is stability in the tax regime.

The industry can recover because there is a huge amount of illegal products in the country and Ficci estimates the revenue loss on account of that to be Rs 13,000 crore. Even the farmers lose a lot because the smuggled or illicit cigarettes do not actually use the tobacco that is made in India. Indian manufacturers also lose and so nobody gains in the process. This to my mind is the biggest challenge that the industry faces.

Look at the valuation of FMCG stocks in India and compare them with ITC valuations. Why are markets not realising the potential of a true franchise like ITC which is a cash generating machine and yet the PE multiples are so smashed out?

I wish I had an answer. I believe that the PE multiples are much lower than what they should be. I understand that there are concerns from a taxation perspective. There are anxieties on that respect and every time an event comes which could lead to tax change, an anxiety develops. There have also been some pressures on account of views on ESG.

I agree that investors should look at free cash flows that the company is generating and I would say the performance was quite resilient despite a very difficult period in the last five-six years. Taxation has more than tripled in the last few years but we have also been part of the larger macro ecosystem and we have been impacted with that. There have been many events that we have gone through besides taxation and yet performance held on a steady basis, continuing to improve in periods of stability. We actually went into double digit bottom line growth.

We have demonstrated resilience. We have free cash flows. Given that a lot of our investments in new businesses in this current phase is getting concluded and because we were building the foundation, the incremental investments in future will not be as much. Therefore, the board has taken a view on the dividend distribution policy.

The dividends are going to be between 80% and 85% and so from a dividend yield perspective, it is a big positive.

The FMCG segment which is a segment which typically draws very high multiples in India, now we have got scale there. What people argue is on the bottom line but we must keep in mind that our bottom line includes the cost of gestation of brand building and within our portfolio, we have many small and nascent businesses which we are incubating for the future.

We have taken a view from a food perspective that we wish to put in place world class infrastructure which will

ensure that our product safety, hygiene standards are top of the line and to some degree, we have invested ahead of time there. It provides an enormous headroom to grow and secondly is the manner in which we have invested.

We have also created structural advantages in the supply chain because foods is a very freight intensive business. It is about proximity to the markets, it is about freshness, it is about producing layers in the distribution chain so that our cost of distribution reduces and as our relatively older businesses are becoming bigger, you are seeing the impact on our bottom line. Between 2017 and 2019, we have increased by 2.6 times and if you look at this year also, YTD EBITDA has moved by nearly 2 percentage points.

I also would like to keep in mind all other businesses which are older for us, where we have demonstrated capability to provide best in class profitability or at least in some businesses, aligned with the best in the industry. You will also notice that we have built it patiently. We have built the foundation and then got the results and it is the same process here because we are here for the long term, we are here to build a large economic engine for ITC and over time, I am sure the results will be more than visible.

How far away are we from benefiting from the brand and the distribution reach of ITC? Do you think in the next three years we will see automatic effects of that coming in the bottom line?

Industry benchmarks will take some time because in our portfolio itself, there are many businesses which are small and have to be incubated. In the last two-three years itself, there are a number of new categories we have entered into. We have gone to frozen snacks, floor cleaners, coffee, chocolates, dairy beverages as well as fresh dairy.

There are many segments that we have added to our portfolio. Each one of them will take some time to mature and as you rightly said, the investments in brand building and gestating cost of capacity which is ahead of demand, is a certain thing that will have to be factored in.

But businesses which are relatively larger and which we started early in our journey are providing good financial metric and within three years, the impact will be seen because the way we are making progress, I do not see any reason why the trend will not be continued. Margin should be improving year on year for sure.

What stops the board then from dividing the company into two -- the FMCG business and the tobacco business? Would that not generate a lot of shareholder value?

This topic has been raised often but you have to really answer the question by simply looking at which situation is going to create greater value. There are a few things that are advantageous when we are combined as an organisation. One is that we are able to leverage a large and robust distribution and logistics highway and these are all high cost elements in any company's operations. Splitting it will mean duplication of resources.

Second, what is the value that you are creating out of the synergy of being together? You spoke about tobacco and FMCG. You could even argue about hotels but there is a lot of value that is created by our hotels business and foods business interacting very closely.

In ITC Masterchef's frozen snacks that we launched, all the seasoning and the textures etc were recommended and tested by our chefs in the hotels. Today, we are deriving far more value by being together than being separate. In fact, about two, three years back, when Michael Porter was in India, he gave the Porter Prize to us for corporate governance and integration. The integration piece is about how you create synergy out of diversity.

That is something which has helped us with grants and has helped us come out with innovative solutions. We are able to cross pollinate ideas from one business to the other. Some of the principles that we have used in our traditional businesses, we have used for example, in creating Aashirvaad Atta which is the market leader today.

All this happens when people interact closely, have an opportunity to look at things together and debate it so that is where cross pollination of ideas comes. It is really about how much synergy you create. At some point of time in future, when each of these businesses are mature, then this whole thing can be revisited. But in today's context, we are creating a lot of value through synergy.

Now is cigarette business is throwing up a lot of..

I am really talking about the synergy that exists from a FMCG perspective and the other businesses of course, are already mature.

What about the current cash flow of ITC? Tobacco business is the cash generating machine. In FMCG, bulk of the expansion in terms of investments is over. You are a large hotel chain now. So you will not be expanding and not much cash is going to be required. The paper business also has reached a size and still generates a lot of cash. Would you be diversifying into another vertical now?

As I said, since our investment requirements are going to be smaller going forward, we have already announced in our dividend policy that the payout ratio will be much higher. As far as our portfolio business is concerned, In today's hyper competitive world, it is very important for any company to play to its strengths and the portfolio that we have today is one where our capabilities and institutional strengths are really leveraged well.

This portfolio aligns well with the opportunities in the marketplace, whether it is FMCG, whether it is agriculture, whether is paper board and packaging and over a period of time even hotels. So all these businesses have got huge headroom to grow and we will be investing to strengthen and grow these businesses.

In hotels, we are moving to an asset right model. After we finish the current projects in the pipeline, there will be much lower levels of investments. It is more working with other hotel owners and helping them run their operations with the portfolio of brands that ITC has got. That is what the focus will be. We are going to focus on these verticals. There is a huge room to grow there and we have a very huge aspiration in FMCG.

The first step is that we have got into a number of categories in the recent past. We are going to scale up these categories, make them market leaders and once these categories scale up, we will explore other areas because we want to make the FMCG space really big.

We have the institutional capabilities, if you look at our foods business, the strength of agriculture, the strength of cuisine, the strength of distribution, the strength of R&D, the strength of packaging innovation, all the elements are together and that is where we will focus.

Could I say that in three to five years, the FMCG business turnover could be higher than the tobacco business?

Well that I do not know but all I can say is that our non tobacco businesses will grow at a much higher rate. There is a base effect also that you must factor in. But the rate of growth in the non tobacco segment will certainly be much faster.

With every change of leadership at ITC, the business of ITC has also evolved and morphed with the market. What is on your priority list? What do you think would be the hallmark of Sanjiv Puri's era for ITC?

ITC's credo is nation first, Sab Saath Badhein. I would like to live this philosophy in whatever business we do and that is the DNA of the company. I was very happy to hear the honourable prime minister speaking about self reliance and the finance minister also clarified that it is not about isolation but it is about a stronger, more resilient India. That is the philosophy with which we have always operated and that is manifest in our investments in trying to create world class Indian brands.

If you look at Aashirvaad Atta, there is the wheat value chain behind it. For us, it is not just about procurement it is also about working with the millions of farmers so that their productivity and quality and realisations improve.

When we started juices, we said if we have to create value, we must use fruits from India. So, our is the only brand that uses 100% Indian fruits. Look at the example of agarbatti. We import a lot of these bamboo sticks. India cannot be strong if all these things are going to be imported because a lot of livelihoods are created out in the farm fields, agro forestry and agriculture as compared to simply in the factory.

Two years back, we started the work with the certain governments and have started the plantation of a variety of bamboo that is required for agarbatti sticks, next year we will be harvesting the first crop. This is the way we should be conducting business so that we are contributing to building inclusive value chains, creating livelihoods. Today, e-chaupals empower four million farmers. This is what ITC stands for, that is what ITC would like to be remembered for and as an employee of ITC, that is what I would like to be remembered for.

That is the philosophy and the manner in which we conduct our business. There could be some opportunities in adjacent businesses but what is core to us is this whole philosophy of being able to contribute to the society.

In this entire lockdown period, personally for you, what has been your toughest moment and your happiest moment?

The toughest moment was when the lockdown was announced and you suddenly found everything unsettled. At that moment, one could not imagine how we will realign and manage in such a situation. The happiest moment was the next day when we all realised that we can actually do it.