

November 27, 2020

ITC Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	500.0	500.0	[ICRA]A1+; reaffirmed
Total	500.0	500.0	

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of the rating considers the dominant position of ITC in the domestic cigarette market, which resulted in strong cash flows, despite lower sales volumes in the current fiscal, a highly favourable financial profile characterised by strong return on capital employed (RoCE), a conservative gearing and large cash and liquid investments. ITC is also the leading company in the paperboards and specialty packaging segments in India and has a strong presence in FMCG, hotels and in the trading of agricultural commodities. While reaffirming the rating, ICRA has also noted the robust performance of ITC's FMCG Others business segment in the current year, driven by a strong demand for staples, convenience foods and health and hygiene products. The agriculture business continues to support ITC's other businesses in terms of sourcing of the required raw materials. ICRA notes that the nationwide lockdown in April and May 2020 to contain the spread of the Covid-19, followed by sporadic localised lockdowns caused disruptions in manufacturing as well as distribution of cigarettes. In addition, a ~13% increase in tax incidence on cigarettes from February 2020 also had an impact on the performance of the division. Consequently, the performance of the cigarette division moderated with the segment revenue declining by ~17% and the PBIT margins witnessing a moderation of ~50 basis points (bps) (adjusted for increased excise duty impact). ITC's hotel division has also been adversely impacted due to restrictions on travel and tourism while closure of educational institutions across the country weighs on the performance of the education and stationery products business in the current year. Nonetheless, strong financial performance of the FMCG-Others and the agri business divisions is expected to continue to support the overall revenues and profitability in FY2021. Further, highly favourable capital structure with no external debt and a substantial cash balance and large liquid investments on its books remain strong sources of financial flexibility for the company.

Key rating drivers and their description

Credit strengths

Market leader in cigarettes, with a dominant market share and a strong presence in the almost price-inelastic premium segment – ITC is the market leader in the organised domestic cigarette industry, with a market share of over 80%. The cigarette business remains the mainstay of ITC's revenues and profitability. In FY2020, the cigarette segment contributed ~46% to ITC's segment revenues and 84% to its segment PBIT.

Increasing diversity in revenue mix with strong inter-segment synergies – ITC has a diversified portfolio with an established presence in cigarettes, FMCG, paper and paperboards, agri-business and hotels. Cigarettes contributed 41% to ITC's consolidated gross segment revenue, followed by FMCG-Others at 22%, agri-business at 18%, paper and paperboards at 11% and hotels at 3% in FY2020. The agri business and the paper and packaging business support ITC's other businesses in terms of sourcing of the required raw materials, and the packaging requirements, respectively.

Improved performance of FMCG-Others Segment – The FMCG-Others division has posted a robust growth in the current fiscal with gross revenues increasing by ~15% in H1 FY2021 compared to the same period last year. Despite subdued demand from discretionary and education and stationery product categories, the performance of this division was driven by a strong demand from staples, convenience foods and health and hygiene products and ITC's robust distribution network. The segment PBIT also increased to ~Rs. 412 crore in H1 FY2021 from Rs. 172 crore in H1 FY2020 due to an increase in the scale of operations and lower sales promotion and advertising expenditure.

Highly favourable financial profile characterised by high profitability and RoCE, minimal debt, and large liquid investments – ITC has demonstrated its ability to maintain the PBIT margin, which stood at a healthy 37% of divisional revenues in FY2020. In H1 FY2021, the PBIT margins moderated to ~30% due to higher tax incidence on cigarettes with effect from February 1, 2020 and losses from the hotel division due to travel restrictions amid the global pandemic. Nonetheless, on an absolute basis, it remains healthy. Moreover, ITC's net profitability continues to be supported by the healthy returns from its investment portfolio. As on March 31, 2020, on a consolidated basis, ITC had cash and liquid investments of around Rs. 35,674 crore. The RoCE of the company continues to be healthy and stood at around 33% in FY2020.

Credit challenges

Exposure of the cigarette business, which continues to be the main profit-earning division, to Government policies and regulations – ICRA notes that in the current year, cigarette sales volumes were impacted due to the nationwide lockdown, followed by various localised lockdowns, which caused disruptions in manufacturing and distribution of cigarettes. Additionally, a ~13% increase in tax incidence on cigarettes from February 2020 also impacted the segment profits to an extent. Nonetheless, ITC has been able to maintain its leadership position in the domestic cigarettes industry in a scenario of high taxes and stringent Government policies including implementation of 'The Cigarettes and Other Tobacco Products (Packaging and Labelling) Amendment Rules 2014' from April 1, 2016, which increased the size of the graphic health warning stamped across cigarette packets to 85% from 40% as well as high cess under the GST structure. Strong brand equity, presence of brands across categories and price points, and an extensive nationwide distribution network helped ITC maintain its dominant position in the domestic cigarette market.

Hotel business adversely impacted due to restrictions in travel and tourism – ITC Hotels is the second-largest hotel chain in India, with 108 hotels at 70 locations in the country, operating across multiple market segments. The nationwide lockdown in April and May 2020, to contain the spread of the pandemic, were followed by sporadic localised lockdowns, which caused hotels to either remain shut or they operated at minimal occupancies in Q1 FY2021. While the easing of restrictions has led to some improvement in Q2 FY2021, discretionary travel (leisure or corporate) would remain muted for the next few quarters. Consequently, ICRA expects ITC's hotel division to witness a significant fall in revenues and profits in FY2021. Nonetheless, the hotel division accounts for only ~4% of the total revenue and ~21% of the total capital employed, so the impact on the overall financial performance of the company will be limited.

Liquidity position: Superior

ITC's liquidity position is superior, as reflected by a healthy cash and liquid investment portfolio of Rs. 35,674 crore as on March 31, 2020. ITC remains debt free as on date. Healthy accruals from the business, combined with lack of debt obligations, lead to a very strong liquidity profile.

Rating sensitivities

Positive triggers – Not applicable

Negative triggers –Pressure on ITC’s rating may arise if there are any adverse regulatory changes in the cigarette industry, which may have a material impact on the profit metrics of the company or if there is a large debt-funded inorganic/organic growth plan, relative to the existing balance sheet size, which may adversely impact the coverage indicators and liquidity position.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of ITC Limited. As on March 31, 2020, the company had 16 subsidiaries, eight stepdown subsidiaries, six associates and four JVs, that have been enlisted in Annexure-2.

About the company

Established in 1910, ITC is the largest cigarette manufacturer and seller in the country. ITC operates in five business segments at present — FMCG Cigarettes, FMCG Others, Hotels, Paperboards, Paper and Packaging, and Agri Business.

In FY2020, the company reported a PAT of Rs. 15,584.6 crore on an operating income of Rs. 49,404.1 crore compared to a PAT of Rs. 12,824.20 crore on an operating income of Rs. 48,352.68 crore in FY2019.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	48352.7	49404.1
PAT (Rs. crore)	12824.2	15584.6
OPBDIT/OI (%)	38.4%	39.2%
PAT/OI (%)	26.5%	31.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	259.9	237.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)			Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019	FY2018
					27-Nov-2020	1-Nov-2019	15-Oct-2018	30-Oct-2017
3	Commercial Paper	Short Term	500.0	0.0	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [click here](#)

Disclosure: A Member of the Board of Directors of ICRA Limited is also an Independent Director on the Board of Directors of ITC Limited. This Director was not involved in any of the discussions and processes related to the Rating of the instrument(s) mentioned herein.

Annexure-1: Instrument details

ISIN No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
N.A.	Commercial Paper Programme	Not issued	-	-	500.00	[ICRA]A1+

Source: ITC Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Russell Credit Limited	100.00%	Full Consolidation
Greenacre Holdings Limited	100.00%	Full Consolidation
Welcom Hotels Lanka (Private) Limited	100.00%	Full Consolidation
Technico Agri Sciences Limited	100.00%	Full Consolidation
Prag Agro Farm Limited	100.00%	Full Consolidation
Pavan Popular Limited	100.00%	Full Consolidation
ITC Infotech India Limited	100.00%	Full Consolidation
ITC Infotech Limited, UK	100.00%	Full Consolidation
ITC Infotech (USA), Inc.	100.00%	Full Consolidation
Indivate Inc.	100.00%	Full Consolidation
Landbase India Limited	100.00%	Full Consolidation
Bay Islands Hotels Limited	100.00%	Full Consolidation
Technico Pty Limited	100.00%	Full Consolidation
Technico Technologies Inc.	100.00%	Full Consolidation
Technico Asia Holdings Pty Limited	100.00%	Full Consolidation
Technico Horticultural (Kunming) Co. Limited	100.00%	Full Consolidation
ITC Investments & Holdings Limited	100.00%	Full Consolidation
MRR Trading & Investment Company Limited	100.00%	Full Consolidation
Fortune Park Hotels Limited	100.00%	Full Consolidation
Gold Flake Corporation Limited	100.00%	Full Consolidation
Surya Nepal Private Limited	100.00%	Full Consolidation
North East Nutrients Private Limited	76.00%	Full Consolidation
Wimco Limited	98.21%	Full Consolidation
Srinivasa Resorts Limited	68.00%	Full Consolidation
Gujarat Hotels Limited	45.78%	Equity Method
International Travel House Limited	48.96%	Equity Method
ATC Limited	47.50%	Equity Method
Divya Management Limited	33.33%	Equity Method
Antrang Finance Limited	33.33%	Equity Method
Russell Investments Limited	25.43%	Equity Method
Maharaja Heritage Resorts Limited	50.00%	Equity Method
Espirit Hotels Private Limited	26.00%	Equity Method
Logix Developers Private Limited	27.90%	Equity Method
ITC Essentra Limited	50.00%	Equity Method

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