

ITC: CREATING ENDURING VALUE

Building World-Class Brands For India

Speech by Shri Y.C. Deveshwar
Chairman, ITC Limited
at the
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Enduring Value for our nation - a commitment that is now proudly expressed through the new tag line that adorns the ITC logo. I hope that every time this logo is seen in your Company's products and services, in the physical infrastructure manifest in its assets, and in the social initiatives that span across the country, it will remind our stakeholders of ITC's timeless commitment to create Enduring Value and of our resolve to always put India First.

As we move towards new horizons, I draw strength from Team ITC and from their dedication to take your Company to even greater glory in the coming years.

As I conclude, may I on behalf of the Board and the employees of your Company once again thank you, our valued shareholders, for your continued support and encouragement.

Thank you, Ladies & Gentlemen.

Ladies and Gentlemen,

It gives me much pleasure to welcome you to the **102nd Annual General Meeting** of your Company.

I am sure you share my sense of satisfaction at yet another year of robust growth of your Company. This performance is even more heartening given the challenging circumstances in the global economy and the slowdown in India.

It also bears testimony to the robustness of your Company's strategy of pursuing multiple drivers of growth. This portfolio of traditional and greenfield businesses has built a strong foundation to power the ITC of tomorrow and create enduring value for the Indian society.

As in earlier years, I would like to first present to you the highlights of your Company's Triple Bottom Line performance for the year gone by.

ITC: TRIPLE BOTTOM LINE PERFORMANCE

Gross Revenue for the year grew by 19.9% to over ₹ 41,800 crores. Net Revenue at over ₹ 29,600 crores was primarily driven by a 26.4% growth in both the non-cigarette FMCG as well as the Agri business segments. Profit before tax increased by 20.1%, crossing the ₹ 10,000 crore milestone, while Net Profit grew by 20.4% to over ₹ 7,400 crores.

The non-cigarette segment net revenue has grown 14-fold from about ₹ 1,360 crores in 1996 to nearly ₹ 19,500 crores in FY13. As a result, 58% of net segment revenue of your Company is now from businesses other than cigarettes.

Apart from being the country's leading FMCG marketer, your Company is also 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 largest Hotel Chain in India and a trailblazer in 'green hoteliering'. Your Company's wholly-owned subsidiary, ITC Infotech, is one of India's fast-growing IT companies in the mid-tier segment. This portfolio of rapidly growing businesses considerably enhances ITC's capacity to generate growing value for the Indian economy.

Your Company is also one of the most influential stocks in the Indian bourses and has created substantial value for its investors over time. Market capitalisation, which stood at ₹ 5,570 crores in 1996, has multiplied **over 50 times** to around ₹ 2,90,000 crores. Total Shareholder Returns, measured in terms of increase in market capitalisation and dividends, have grown at a compound annual rate of over 27% during this period.

such a repertoire of intellectual property and brands that sustainable wealth and livelihood opportunities can be multiplied in the country.

CONCLUSION

The journey to create world-class brands in India by domestic enterprises will remain extremely challenging. Multinational Corporations have the benefit of vast resources that lend staying power over the long run. Yet it is important not to relent, and not to give up. **India's abilities are second to none and have been celebrated across the world. It is now important to harness these energies to create world-class Indian brands that will bring pride to our country.**

Your Company has left no stone unturned to move ahead on this journey based on the strength of its convictions, its proven capability to create winning brands and an abiding vision to put Country before Corporation. It is indeed fulfilling to witness the growing franchise for your Company's young brands, and to know that these vital brands have created much larger value in the form of sustainable livelihoods and environmental replenishment. **This exemplary triple bottom line performance, to my mind, is the most enduring contribution of your Company to our Country and to our society at large.**

The aspiration to create world-class Indian brands is your Company's commitment towards creating

The last Budget tried to bridge this lacuna by raising the withholding tax to 25%. In effect however, in almost all cases, this higher rate of withholding tax is not applicable due to the much lower withholding tax enshrined in the tax treaties. As a consequence, the potentially growing adverse impact on tax collection will need to be bridged by an additional burden that Indian enterprises will have to bear, further constraining their ability to build world-class brands.

It is vital that the policy environment incentivises the creation of Indian brands. **For example, since foreign brands entail a royalty outflow, a similar percentage of turnover of Indian brands should also be admissible as a deductible expense for the computation of corporate tax to create a level playing field for domestic enterprises.** These resources can then be deployed for the development of R&D, intellectual property in India as well as for brand building purposes. In fact, a larger deduction should be admissible for new brands for the first 10-15 years of their existence.

It goes without saying that the most durable solution to manage the Current Account Deficit lies in making the Indian economy globally competitive in value-added goods and services. As stated earlier, **the future will indeed belong to those who have the foresight and endurance to create unique and differentiated intellectual property assets.** It is primarily by developing

(Figures in ₹ Crores)

ITC : Financial Highlights 1996-2013		
	1996	2013
Gross Income	5,188	43,044
Net Segment Revenue (other than Cigarettes)	1,363	19,494
Profit After Tax	261	7,418
Net Assets Employed	1,886	23,569
Market Capitalisation*	5,571	2,90,000*
CAGR in Total Shareholder Returns in the period 1996-2013 : 27%		

**As on 19th July, 2013*

It is also gratifying that your Company's exemplary sustainability initiatives continue to receive accolades and global recognition. ITC has been ranked No. 1 as the 'Most active in CSR' for two successive years in the Nielsen Corporate Image Monitor. The Bombay Stock Exchange recently instituted two indices titled 'GREENEX' & 'CARBONEX' evaluating several green operational parameters, including carbon performance. It is a matter of pride that your Company has been assigned the highest weightage in both the indices.

ITC continues to be the only enterprise in the world of comparable dimensions to be carbon, water and solid waste recycling positive. These global environmental distinctions have been sustained even though your Company's

operations have grown substantially over the years. **Your Company has been water positive for 11 consecutive years; carbon positive for 8 years now and solid waste recycling positive for the last 6 years.**

New benchmarks are being attained with renewable energy constituting over 41% of ITC's total energy consumption. This is a remarkable achievement given the scale and spread of your Company's units. Several factories as well as 5 premium luxury hotels and the ITC Infotech Park meet 100% of their power requirements from wind energy. The iconic ITC Grand Chola, unveiled in Chennai last year, achieved the distinction of being the world's largest LEED (Leadership in Energy and Environmental Design) Platinum certified hotel in the New Construction category. It was also awarded India's first 5 Star GRIHA (Green Rating for Integrated Habitat Assessment) rating by the Ministry of New and Renewable Energy. This is yet another laurel for ITC Hotels, reinforcing its unique position as the greenest luxury hotel chain in the world with every hotel in the chain being LEED Platinum certified.

Your Company's businesses and the associated value chains today support sustainable livelihoods for more than 5 million people, representing some of the weakest in society. I am sure this large-scale and meaningful contribution of your

the inflow of technology, know-how and investment in areas critical for India's growth and development. There should certainly be no restrictions or Governmental intervention in transactions between two unrelated parties carried out purely on a commercial and arms-length basis. However, such limitless freedom can be misused as an instrument of tax avoidance between two related parties and thus pose a significant risk to the Indian exchequer and to the Current Account balance.

As I have stated earlier, a long-term sustainable solution is to build India's own Intellectual Property in all important spheres ranging from pharmaceuticals, consumer goods to services. As things stand today, tax accrual to the Indian exchequer can be significantly reduced by virtue of ownership of brands overseas. This is due to the considerable difference in Withholding Tax on royalty payments and the rate of Corporate Income Tax providing an arbitrage opportunity. This unintentionally incentivises the foreign-owned brands as well as the development of intellectual property overseas.

The policy framework should be such that encourages the flow of technology, know-how and investment into India and yet prevents misuse as an instrument of tax arbitrage between related parties.

for tomorrow's world-class brands and the basis for the country's future progress.

NEED FOR A BALANCED POLICY FRAMEWORK

Your Company's progress towards building world-class Indian brands, though impressive, is still in its infancy. The challenge of Indian brands gaining an equitable share of even the domestic middle-class consumer spend looks daunting. With the progressive rise in per-capita income, and 10-15 million youth coming into the job market every year, consumption of branded goods will grow exponentially in the coming years. Given the overwhelming dominance of foreign brands in the domestic market, and with the removal of the ceiling on royalty payments, this can further aggravate the current account imbalance. Such a source of imbalance would be intractable as it would flow directly from domestic consumption linked to consumer preference and habit. It is therefore imperative that the policy framework is reviewed with an added objective to create an environment that helps build and nurture world-class Indian brands in every consumer segment of the domestic market.

It is my belief that the removal of caps on payments such as royalty was well intentioned. It was with the objective to create conditions for

Company to the national goal of sustainable and inclusive development gives you justifiable pride and a sense of great satisfaction.

A proud moment this year was the global recognition from one of the world's most respected publications. Based on ITC's consistent triple bottom line performance over 15 years, the Harvard Business Review in January 2013 ranked your Company's Chairman as the 7th Best Performing CEO in the world. I would like to take this opportunity, on behalf of the Board, to thank you and all stakeholders of ITC, including every member of Team ITC, for the unstinted support throughout this eventful journey. Your collective commitment provides the inspiration to attain newer heights of success for your Company in the future.

INDIA'S ECONOMIC CHALLENGES

Five years after the outbreak of the global financial crisis, the world economy continues to remain fragile. The Indian economy demonstrated remarkable resilience in the initial years of the contagion but finally lost ground last year. GDP growth slowed down to a 10-year low of 5%. There was a marked deceleration in agriculture, industry and services. Dampening sentiment led to a cut-back in investment as well as private consumption expenditure - two principal drivers of growth. Inflation remained at high levels

fuelled by the pressure from the food and fuel sectors. The large fiscal and current account deficits continued to cause grave concern.

It is imperative that India regains its growth trajectory of 8-9% sooner than later. This is crucially important given the need to create gainful livelihood opportunities for the millions living in poverty as also the large contingent of young people joining the job market every year. Therefore, the core challenges that constrain high rates of growth must be addressed comprehensively and speedily. Foremost among them is the urgent need to contain and find a longer-term solution to deal with Inflation, the Fiscal Deficit and the Current Account Deficit. The Government has announced several policy measures in recent times to tackle these challenges. It is hoped that investor and consumer sentiment would get re-ignited to put the country once again on a high growth path.

To my mind, one of the most critical problems hindering India's growth prospects is the unsustainable Current Account Deficit. The persistently large deficit reveals that the country is yet to attain international competitiveness in several segments of its economy. This is starkly manifest in the composition of India's trade basket. Imports are largely of high-value added goods and services, while exports comprise mostly commodities or relatively lower-value added

nation's tourism landscape and as a multiplier of employment opportunities. Its cuisine excellence is legendary with globally acclaimed branded restaurants, such as 'Bukhara', 'Dum Pukht', 'Dakshin', 'Peshawari', 'Royal Vega' and 'Pan Asian'. Your Company's contribution to the tourism sector is further enhanced by brands such as 'WelcomHotel', 'Fortune' and 'WelcomHeritage'.

ITC: Building Innovative Capacity

The ability to innovate and create unique products based on deep consumer insight is at the heart of gaining sustainable consumer franchise. Product development based on cutting-edge R&D, ownership of unique intellectual property, development of proprietary technology and know-how are the levers that can move the markets of tomorrow. Recognising this, the dedicated state-of-the-art '**ITC Life Sciences and Technology Centre**' has been expanded and nurtured over the years as an integral part of your Company's endeavour to be in a state of future-readiness at all times. A large pool of highly qualified scientists with global exposure is engaged in finding solutions which we hope will enrich consumer experience in many ways. Your Company takes pride in its fraternity of scientists, who are deeply charged by the inspiration to build a new India. They are indeed contributing to a national cause of building intellectual property in India, sowing the seeds

initiative, have empowered over 4 million farmers. The **ITC Choupal Integrated Watershed Development initiative** provides soil and moisture conservation to over 1,20,000 hectares. The **ITC Choupal Livestock programme** has provided Animal Husbandry services to over 8,00,000 milch animals, thereby strengthening the dairy value chain and creating livelihood opportunities. The **ITC Choupal Women's Empowerment programme,** has benefitted more than 40,000 rural women and is supported by the Agarbatti value chain powered by ITC's Mangaldeep brand. These deep rural linkages, nurtured over the years, have remarkably enriched the rural eco-system in areas where your Company operates.

ITC's brands in packaged consumer goods as well as education and stationery products anchor the **ITC Choupal Social and Farm Forestry initiative.** This programme has greened over 1,45,000 hectares, providing more than 65 million person-days of employment opportunities to poor tribal communities and farmers. Renewable plantations enable your Company to offer the greenest paper and paperboards manifest in its stationery brands such as 'Classmate' and 'Paperkraft' and in the packaging of branded consumer goods.

'ITC Hotels', with its credo of Responsible Luxury, is a world-class brand that has redefined the fine art of green hospitality, contributing to the

products and services. It is a matter of concern that even the non-oil, non-gold imports have risen so sharply. For long-term macro-economic stability, it is desirable that the trade account gets balanced on the strength of the competitiveness of Indian goods and services in the export markets rather than on capital flows to finance the deficit. Competitiveness will create the conditions for higher value-added exports and reduce reliance on a falling rupee. Similarly, it can contribute to a larger degree to import substitution to stem the over-dependence on high value-added imports.

Therefore, it is very clear that the only sustainable solution to tackle the large Current Account Deficit is to create extreme competitiveness in higher value-added goods and services. That is indeed a daunting task but one that holds the promise of transforming the Indian economy into a high-value creating engine of growth to service the domestic as well as export markets.

It is my belief that tomorrow's world belongs to those who create, nurture and own intellectual property. Such assets form a superior basis for sustaining competitive advantage over the long run. The large current account imbalance also reveals the paucity of domestically owned intellectual property assets. This in turn creates an over-dependence on foreign intellectual property to service even the home market. As a

consequence, there is an increasing outflow of payments to overseas entities on account of charges for the use of their intellectual property resident in patents, trademarks, copyrights, industrial processes, designs and so on. These transfers are over and above the large deficit on account of merchandise trade. This over-reliance on foreign-owned intangible assets constitutes an in-built source of future unsustainability of the current account imbalance. **Therefore, creation of intellectual property assets is a vital pre-requisite for attaining international competitiveness.**

THE INDIAN GLOBAL MARKET: DOMINANCE OF FOREIGN BRANDS

In recent times, several media reports have drawn attention to the extraordinary increase in royalty payments to overseas entities. The ET Intelligence Group in one such report brought out that royalty payments by Indian arms of top MNCs have trebled over the past 5 years. The report points out that in FY12, 306 listed companies paid royalty and technical fees aggregating almost ₹ 35,000 crores. A similar analysis by Business Standard of 75 BSE500 companies reveals that these firms paid out royalty equivalent to 32% of their net profits in FY12.

It is perfectly legitimate that owners of intellectual property seek returns for the use of their assets. However, these media reports have highlighted

nurtured by your Company have been able to outclass any foreign brand by a long margin. The threat from foreign brands, however, is growing due to the exponential growth of contraband cigarettes induced by the high rates of Central & State duties imposed on domestic manufacture.

The leadership of our cigarette brands provides the basis for the cash flows that are enabling the creation of world-class Indian brands in multiple consumer segments. They are also the basis for building the capital-intensive Hotels and Paperboards businesses. Along with Packaging, Information Technology and Agri Businesses, these together constitute vital assets that enable your Company to contribute to all the three sectors of the economy - namely, agriculture, manufacturing and services. These assets have also enabled your Company to be a net earner of Foreign Exchange. In the last decade, ITC group's foreign exchange earnings exceeded US$ 5.4 billion.

ITC Brands: Anchoring CSR and Environmental Sustainability

Your Company's brands anchor the competitive development of value chains extending to the country's rural areas and backward regions.

Brands such as 'Aashirvaad', 'Sunfeast', 'Yippee!', 'Bingo!', 'Kitchens of India', together with your Company's Agri Businesses and the **ITC e-Choupal**

'Sunfeast' have already garnered annualised consumer spends of over ₹ 2,000 crores each. 'Aashirvaad' atta is the clear market leader in its segment. The 'Sunfeast Dark Fantasy' brand has also emerged as a market leader in the premium cream biscuits category. In the confectionery business, your Company's brand 'Candyman' is the leader in its operating segment. ITC's 'Kitchens of India' brand leads the gourmet cuisine Ready-to-eat packaged foods market. Within a short time, your Company's instant noodles 'Yippee!' brand has moved to the 2nd position rapidly gaining market share. In addition, the 'Classmate' brand of notebooks and scholastic products has notched up a consumer spend of ₹ 1,000 crores while 'Bingo!', 'Candyman' and 'Vivel' are estimated to have attracted consumer spend of over ₹ 500 crores each.

The consumer response to your Company's Personal Care brands such as 'Essenza Di Wills', 'Fiama Di Wills', 'Vivel' and 'Superia' show promise. The recently launched skincare brand 'Cell Renew' and the 'Engage' brand of deodorants have both been well received. ITC's apparel brands 'Wills Lifestyle' and 'John Players' have garnered an impressive consumer franchise in a market replete with foreign brands. One or the other of your Company's apparel brands is available in nearly 2,500 outlets spread across the country.

India is perhaps the only country in the developing world where domestic world-class cigarette brands

that the sudden surge in payments took place following the removal of the ceiling on royalty payments in December 2009. These reports seem to suggest that a substantial part of this increased outflow was on account of payments made by the Indian subsidiaries to their overseas parent for the use of brand names established several decades ago. It was further indicated that this spurt in payments did not reflect any noteworthy value-addition from technology transfer by the foreign entities. These media articles also expressed concern at the adverse impact of this huge outflow on minority shareholders and on the exchequer.

Reflecting on these reports, it must be said that the concerns expressed are not without merit. At the core of this issue is the increasing consumption of foreign-owned brands by a rising population with growing per capita income. These range from run-of-the-mill to high-end luxury products. A closer look, however, reveals an unnerving picture. Today, even for items of daily consumption, the brands consumed by millions of households in India are predominantly owned by overseas enterprises.

The list is large and unending. Be it baby food, baby care products, home care & personal care products, toothpastes, toothbrushes, shaving creams, razors, breakfast cereals, snack foods, tea, coffee, cosmetics, soaps,

shampoos, detergents, dish cleaners, beverages, ice creams, chocolates, confectionery, non-generic pharmaceuticals, washing machines, music systems, personal computers, laptops, refrigerators, mobile phones, televisions, cameras, air conditioners, apparel & fashion accessories, stationery products, toys, console games, sports and fitness equipment, luggage, diapers, sanitary napkins, burgers and pizzas, automobiles and many others, including even packaged drinking water, the leading brands in the Indian market are the property of foreign enterprises. Every time any of these products are consumed, value flows out of the country to pay for trademarks used, licences provided, services consumed and so on. With rising aspirations and growing disposable incomes, this outflow has the potential to increase exponentially over time. These foreign brands have so much been a part of the daily lives of Indian households, and for so long, that most people would genuinely think that they are Indian brands. A majority would have no inkling that every purchase would send value out of the country to the foreign owners.

This unenviable situation is indeed a disheartening reflection of the competitive capabilities of India's home-grown brands. Despite so many years of Independence and the country's multi-dimensional strengths, it is a sad augury that we

In my earlier addresses, I have expressed ITC's aspiration to be the No.1 player in the FMCG sector in India, without taking into account its cigarette business. This is evidently an audacious aspiration and one that may not necessarily be realised in my own lifetime. I, however, wish to place ITC firmly on the path to such accomplishment. I am confident that sooner than later, your Company's aspiration will be realised on the strength of the collective passion that has ignited Team ITC in the pursuit of this goal.

You, the shareholders, can draw confidence from the promise visible in the early successes registered by your Company. Significant consumer franchise has been gained in a relatively short span of time for a range of consumer products. **Your Company's new FMCG businesses have gained considerable traction with the top-line having exceeded ₹ 7,000 crores in the year gone by.** This growth has been rated by a recent Nielsen Report to be the fastest among the consumer goods companies operating in India. **With your support and all going well with a conducive environment, it is within the realm of possibility that your Company can achieve a turnover of over ₹ 1,00,000 crores from its brands in the new FMCG businesses by 2025/30.**

Indeed, the journey has just begun and there are many miles to go. The progress is encouraging and bodes well for the journey ahead. Your Company's brands such as 'Aashirvaad' and

network. Above all, it demands a determination to succeed against all odds. It is perhaps for this reason that some successful Indian brands, built during a relatively protected pre-globalised period, had to succumb to the might of international players, post the opening up of the Indian economy.

It is noteworthy that the developed countries of the world dominate their domestic markets with their own brands. These brands create tremendous value for their countries by serving both domestic and global markets. Closer home, South Korea and Japan offer a case study of how world-class brands were built as a national priority. India can take a leaf out of their books to create a nurturing environment that supports the efforts of domestic enterprises engaged in building world-class brands.

ITC: ASPIRING TO BUILD WORLD-CLASS BRANDS FOR INDIA

Your Company is inspired by the vision to create world-class brands for India. Over the last few years, it has strived relentlessly towards the realisation of this super-ordinate goal. **The mission is to create unique products, born out of deep consumer insight, to win growing consumer franchise and build world-class brands that would progressively dominate the Indian global market.**

do not possess globally competitive brands created by Indian enterprises. True, there are worthy exceptions. Indian consumer brands such as Airtel, Amul, Bajaj, Godrej, Hero, Mahindra, Reliance, Tata, amongst others have found a pride of place in Indian households. Yet these examples are few and far between. For the most part, India's market space has been abdicated to foreign-owned brands.

Be that as it may, apart from a re-examination of the merits of the revised policy currently in force, this issue also needs to be looked through a different lens altogether. **Instead of bemoaning the huge outgo in terms of royalty or other payments, it is much more important to align national and corporate energies to create world-class Indian brands.** Domestic enterprises must build globally competitive brands that can compete with the best in the world on equal terms. In the first instance, such brands by gaining larger franchise in the Indian global market would reduce the outflow on account of consumption of foreign brands in India. Over time, such world-class Indian brands can aspire to win global markets generating an additional flow of wealth into the country.

NEED TO BUILD INNOVATIVE CAPACITY AND WORLD-CLASS INDIAN BRANDS

World-class brands lend a huge intangible value to products and services enabling them to

command a premium and loyalty from consumers. Truly world-class brands are an asset that transcends cultural, geographical and sovereign borders to continuously enrich their owners. Moreover, successful brands reflect the innovative capacity of the countries of their origin. When a country's institutions build world-class brands, they enrich their economies. For example, the net sales of Samsung is equivalent to 20% of the GDP of South Korea. **A successful global brand is a badge of honour for the country it belongs to, and a sustained source of wealth creation.**

The mission to create world-class brands in India must therefore assume the fervour of a national movement. Such world-class Indian brands will help create, capture and retain larger value for the economy. In addition to spurring investments and growth, such brands can become a force multiplier for inclusive and sustainable growth. By serving as market anchors, these brands can lend relative stability to drive the competitiveness of the entire value chain of which they are a part. This in turn can further empower the weakest in the economic value chain and generate considerable sustainable livelihood opportunities so critical for our country.

Progressively, world-class Indian brands can contribute increasingly to import substitution, value-added exports as well as larger value-capture from global markets. This will transform

the country from one dominated by foreign brands to a player of substance in the global arena. **One dreams of a day when Indian brands become household names across the world, standing for superior R&D, impeccable quality and enduring trust.** This is not only a matter of national pride but an economic pre-requisite if we are to gain equitably from a globalised world. There is no reason why the collective might of India's genius cannot rise to this challenge of making India globally competitive.

Despite outstanding entrepreneurial talent, there is no escaping the fact that India cannot boast of globally competitive brands barring a few exceptions mentioned earlier. The moot question therefore is - why is it that the country has not been able to create brands that are in a position of leadership, even for domestic consumption? Building world-class brands is a gigantic task, especially where international brands have had an overwhelming head start and a learning curve spanning multiple decades.

Creation of a new generation of world-class brands demands tremendous staying power with substantial investment commitments over the long run. It requires deep consumer insight, continuous nurturing of R&D, differentiated product development capacity, brand-building capability, cutting-edge manufacturing, and an extensive trade marketing and distribution