

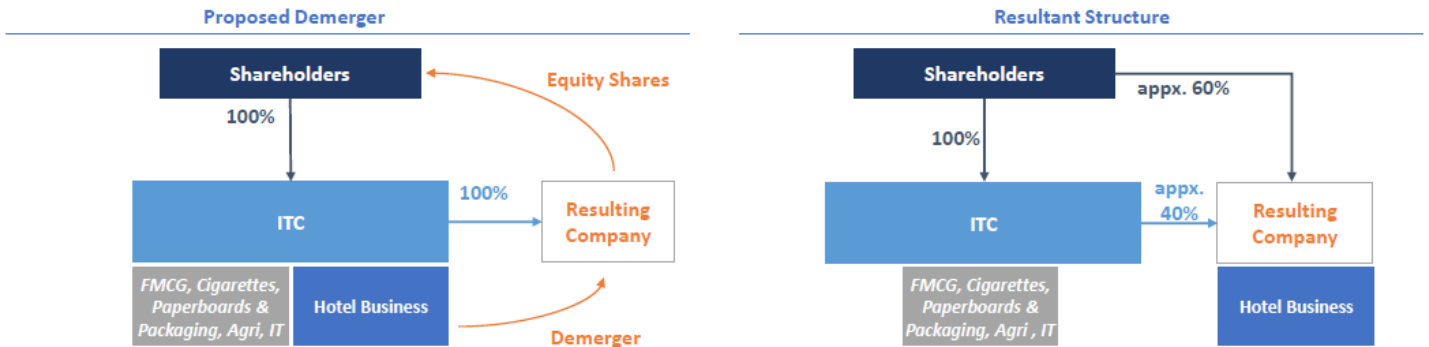
# ITC: DE (MERGER) OF HOTELS BUSINESS



Dear Patrons,

In its exchange filing, ITC Ltd. announced that the board has accorded in-principle approval for the demerger of its hotel's business. Under the proposed scheme, the company would hold a stake of ~40% while the balance would be held by the company's shareholders proportionate to their shareholding in the company (**refer exhibit 1**). The demerged entity will be a wholly owned subsidiary, "ITC Hotels Limited" or any other name as may be approved by the relevant authorities.

**Exhibit 1: ITC shareholders to get a direct stake in a pure play listed Hotel entity**



Source: Company, Ambit Asset Management

**Strategic Rationale**

After two years of pandemic-led disruption, the Indian hospitality industry has witnessed a remarkable recovery, with revenue and profits growing significantly due to increased business travels, weddings, leisure, and return of the MICE (meetings, incentives, conferences, and exhibitions) segments. The company stated that:

- The hotels business is well poised to chart its growth path as a separate entity with a sharper focus on the hotels and hospitality business whilst continuing to leverage ITC's institutional strengths, brand equity and goodwill.
- New entity would operate with an optimal capital structure, with the ability to access equity/debt markets for funding growth requirements.
- Unlock Value for ITC shareholders: Independent market driven valuation of focused new entity.
- The company believes that the demerger will help the new subsidiary attract appropriate investors and strategic partners whose investment strategies and risk profiles align more with that of the hospitality industry.

**About the Hotels segment**

Over the last two decades, ITC has scaled to over 120 hotels and 11,600 keys across over 70 locations. Having achieved considerable scale, the business pivoted to an 'asset-right' strategy in 2018, which envisages a substantial part of incremental room additions to accrue through management contracts. It has a presence across a wide range of price points: 40% of the room inventory is in the Luxury segment, followed by the premium/ upscale segment (30% share) and mid-market (**refer exhibit 2**).

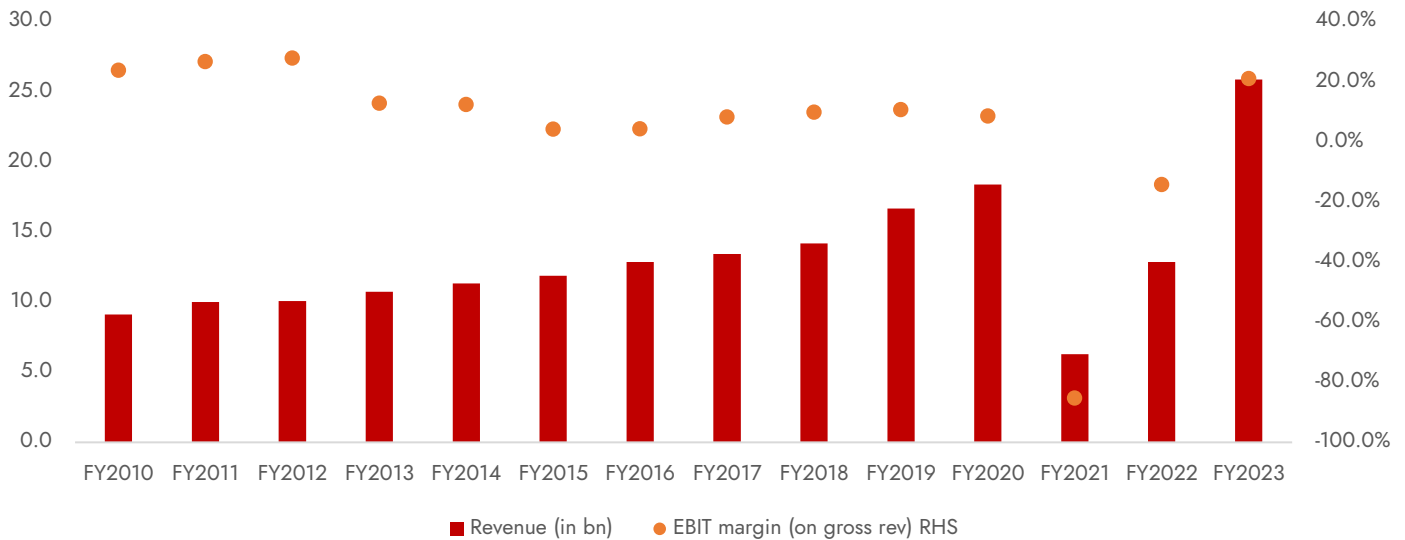
**Exhibit 2: Apart from the brands below, ITC also operates one luxury hotel in Delhi under the Sheraton brand**



Source: Company, Ambit Asset Management

ITC's hotel business has faced pressures in the last decade, due to the cyclical nature of the business, and the subdued average room rates even as it kept adding new hotel properties. Covid-19 further impacted the business in FY21/FY22. However, the segment witnessed recovery in FY23 on the back of the wedding season, leisure and business travel.

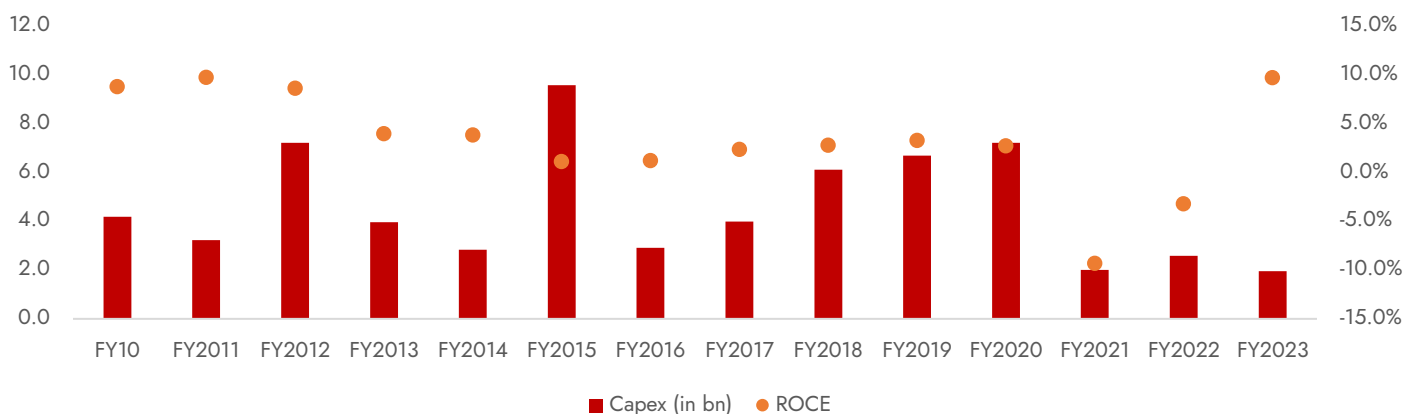
**Exhibit 3: ITC hotels business grew by 5% CAGR till 2018; grew by 12% CAGR from FY18-23**



Source: Company, Ambit Asset Management

The hotel business contributed less than 5% of ITC revenues and EBIT over the last decade. However, it accounted for over 20% of the company's capex. The high capex on the hotel business and the resultant subpar returns have always been a concern. Hotel business accounted for nearly a quarter of ITC's capex over FY10-20 with <5% RoCEs. The demerger will, thus, help unlock the value of the hotel's business for the company's shareholders by providing them with a direct stake in the new entity and an independent market-driven valuation. The hotel business contributed less than 5% of ITC revenues and EBIT over the last decade. However, it accounted for over 20% of the company's capex.

**Exhibit 4: High capex intensity and weak return ratios in the hotel business have been a key concern**



Source: Company, Ambit Asset Management

**Key takeaways from management commentary**

- Aim of the current structure (40:60 structures) in the new entity is to provide: a) stability to the new entity, b) access to brand assets and domain expertise, and c) comfort to stakeholders, including partners and employees. The company will continue to leverage cross-segment learnings for employees going ahead, which will be facilitated by their respective boards.
- The scheme of demerger is likely to be tax neutral for all parties — ITC, the new entity, and shareholders.
- ITC will enter into a Royalty arrangement with ITC Hotels. For usage of ITC and its brands, there would be an arrangement regarding royalty, based on industry benchmarks.
- Management sees a ~18-20% points expansion in ROCE and a ~10% points expansion in ROIC, for FY23..

Going ahead, any further stake dilution will be the decision of the Board and contingent on the situation then. Also, management is clear that the shareholder will take an independent call, concerning their holding in the new entity. ITC is not looking to buy-back shares from existing shareholders.

**Conclusion**

In alignment with the company's 'ITC Next' strategy, the demerger emphasizes sharper capital allocation, future growth, and unlocking value for shareholders. With a focus on better profitability and enhanced competitiveness, the demerger aligns with ITC's principles of agile operations, consumer centricity and innovation. While value unlocking owing to the demerger of the Hotels business is unlikely to be material, we see improvement in ITC's returns profile, post-demerger of hotel operations.

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