

Chairman's Statement

ITC's Vision and Strategy

“Envisioning a larger societal purpose ('a commitment beyond the market') has always been a hallmark of ITC. The Company sees no conflict between the twin goals of shareholder value enhancement and societal value creation. The challenge lies in fashioning a corporate strategy that enables realisation of these goals in a mutually reinforcing and synergistic manner”



I am delighted to present ITC's third Sustainability Report. This Sustainability Report, prepared in accordance with G3, the latest Revision of the Global Reporting Initiative guidelines and assured by PricewaterhouseCoopers Pvt. Ltd., represents a balanced and reasonable presentation of ITC's economic, social and environmental performance.

ITC is committed to sustain its position as one of India's most valuable corporations through world-class performance, creating growing value for the Company's stakeholders and the Indian economy. Over the last decade, Total Shareholder Returns, measured in terms of increase in market capitalisation and dividends, grew at a compound rate of over 30% per annum, placing ITC among the foremost in the country in terms of efficiency in servicing financial capital. ITC aims to sustain its premier market standing and leadership position in each of the business segments.

Sustainability reporting by corporates is of significant relevance and meaning in these times of escalating global opportunities and challenges. Business leadership worldwide is confronted with the realisation that the limits to sustainable growth will be determined less by access to financial capital and more by the commitment to preserve and augment social and ecological capital. Given the growing influence of corporations in driving economic, environmental and social change, investors and other stakeholders will expect the highest standards of ethics, transparency, sensitivity and responsiveness from corporates. It is my belief that stakeholders, including consumers, will increasingly raise the bar of expectation in relation to corporate response to issues of sustainable development. In keeping with this belief, ITC, along with the Confederation of Indian Industry, launched the 'CII-ITC Centre of Excellence for Sustainable Development' in January 2006. The Centre seeks to address the institutional void in developing the requisite capability among Indian industry to pursue sustainability goals. The Centre will endeavour to transform Indian businesses by providing thought leadership, promoting awareness and building capacity.

Development in a country as large and diverse as India poses special challenges. As India embarks on a trajectory of high rates of economic growth, it is imperative to focus on the impact of such growth on society and the environment. Economic growth will translate to sustainable development only when it is inclusive, creating the capacity to consume among those living at the margin – the lion's share of whom are in rural India. Equally, sustainable development will be achieved only when environmental capital is enriched. The sharp decline in per capita availability of water, the low forest cover due to continuing deforestation, increasing levels of air and water pollution, the remorseless increase in the quantum of wastelands and the rising demand for fossil fuels are some of the serious issues that need to be addressed on a war footing if India has to realise its ambitious agenda for sustainable progress.

Envisioning a larger societal purpose has always been a hallmark of ITC – ‘a commitment beyond the market’. This commitment finds expression in the Company’s sustainable development philosophy, which recognises the need to not only preserve but also enrich precious environmental resources while providing a safe and healthy workplace for its employees. ITC sees no conflict between the twin goals of shareholder value enhancement and societal value creation. The challenge lies in fashioning a corporate strategy that enables realisation of these goals in a mutually reinforcing and synergistic manner. ITC’s e-Choupal and social forestry programmes represents just two of the stellar examples of this philosophy in action.

Apart from crafting business models that establish direct linkages between businesses and societal goals, ITC is also engaged in implementing various other sustainable development initiatives towards making a meaningful contribution in the economic vicinity of its operating locations. The thrust of these initiatives, christened ‘Mission Sunehra Kal’, is in three areas: (i) natural resource management, which includes wasteland, watershed and agriculture development; (ii) sustainable livelihoods, comprising genetic

improvement in livestock and economic empowerment of women; and (iii) community development, with focus on primary education and health and sanitation.

ITC seeks to contribute in meaningful measure towards social empowerment and genderised development

ITC is committed to conducting its business operations with passionate respect for the environment. Several prestigious national and international awards (listed elsewhere in this report) testify to ITC’s abiding commitment. Such recognition has further reinforced the Company’s commitment to consciously synergise and direct the collective endeavour of its employees at all levels across all businesses, functions and locations to continuously improve sustainability practices, to ultimately attain and exceed global

standards.

Internationally benchmarked specific consumption of water, dedicated pursuit of the goal of zero discharge and scaling up of rainwater harvesting in several moisture-stressed districts of India have enabled ITC retain its enviable position of a ‘water positive’ Company for the fourth successive year. The water harvesting potential created so far is over four times the Company’s net water consumption.

It is a matter of pride that ITC became ‘carbon positive’ during the year on the back of several energy conservation measures, usage of carbon neutral fuels and carbon sequestration through large-scale agro-forestry programmes. ITC is making rapid strides towards attaining ‘zero solid waste’ status. Upon this

achievement in the near term, ITC would perhaps be the only global enterprise of its size in the world to have achieved these milestones encompassing all three critical facets of environmental sustainability.

In a nation where economic deprivation is widespread and the capacity of a large share of its citizens to participate effectively in economic growth is grossly limited, ITC seeks to contribute in meaningful measure towards social empowerment and genderised development. The ITC e-Choupal and Choupal Saagar infrastructure – a combination of digital, human and physical assets – already serves over 3.5 million farmers and is potentially an efficient delivery channel for rural development. Similarly, ITC's social farm forestry strategy enables the creation of substantial employment both on farms and off farms, besides converting private wastelands into productive assets, and simultaneously addressing serious issues relating to biomass depletion, soil erosion, water security, ecological balance and biodiversity.

ITC dedicates this Report to the cause of the Bharat Nirman programme initiated by the Prime Minister as a leading symbol of public-private partnership in India's development. It also acknowledges the contribution made by the employees of the ITC Group, whose initiative and commitment have enabled the Company make great strides in its sustainability performance.

(YC DEVESHWAR)

Key Impacts, Risks and Opportunities

Economic Impact

If rapid economic growth is to be sustained in a country as large and diverse as India, it is imperative to include those living at the margin as meaningful participants in the economic process. The slow pace of progress so far towards achievement of the Millennium Development Goals highlights the seriousness of the issues relating to human development.

ITC's aspiration to create enduring value for the nation provides it the inspirational motive force to sustain growing shareholder value. ITC practices this philosophy of a 'commitment beyond the market' by not only driving each of its businesses towards international competitiveness, but by also consciously contributing to enhancing the competitiveness of the larger value chain of which it is a part.

Over the past decade, value addition by ITC has grown at a compound annual rate of more than 12% to over Rs. 68,000 crores, representing nearly 1.1% of the value-added by the Industry sector of the economy. Nearly 77% of such value-added accrued to the Exchequer, providing the much-needed resources for deployment in developmental priorities. Foreign exchange earnings of the ITC Group during this period amounted to nearly US \$ 2.5 billion, of which earnings from agri exports constituted nearly 65%. These earnings from linking the Indian farmer with world markets represent well over 2% of the country's agri exports.

ITC's investments of over Rs. 6,000 crores in the last decade towards enhancing the competitiveness of its businesses support direct employment to the tune of 20,000 and indirect employment across the value chains of nearly 5 million people, whose livelihoods are substantially linked to their association with ITC. The investment plans envisaging Rs. 14,000-15,000 crores over the next few years would further enlarge ITC's economic contribution.

ITC's engagement across diverse value chains spans the farming community, small enterprises and shopowners in the small, medium and cottage sectors. The Company's new FMCG businesses alone support the competitiveness of over 120 vendors in the SME sector thereby enabling them to adopt best practices, induct superior capabilities, and eliminate reprehensible practices like child labour. To illustrate, the Incense sticks business sources products from 8 vendors in the cottage sector, who predominantly employ women. Four of these vendors have earned the ISO 9001 certification – a first for this industry. Thus the symbiotic partnership between the Company and such cottage industry vendors leverages complementary strengths for mutual benefit, thereby enabling these enterprises to flourish without the need for public largesse.

ITC's mission of fulfilling a larger social purpose is based on the bedrock of sound financial performance. It is ITC's belief that creation of shareholder value provides the only basis for sustainable contribution to the superordinate goal of creating national value.

ITC aims to sustain its market standing as one of India's most valuable corporations, achieve leadership position in each of the business segments within a reasonable time frame and achieve a Return on Capital Employed (ROCE) in excess of the Company's cost of capital, at all times.

Over the last decade Total Shareholder Returns, measured in terms of increase in market capitalisation and dividends, grew at a compound rate of over 30% per annum, placing ITC among the foremost in the country in terms of efficiency of servicing financial capital. Amongst listed companies in the private sector, ITC ranked 4th in terms of

Gross Turnover and 3rd in terms of pre-tax profits for the financial year ended 31st March 2006. The Company ranked 6th by market capitalisation amongst listed private sector companies in the country, as at 31st March 2006. The Company has consistently achieved a ROCE well in excess of its cost of capital. It is a measure of the continued trust reposed in the Company by consumers that ITC's brands today account for three of the top five FMCG brands in the country.

Just as the Company's businesses have contributed to strengthening its economic value creating ability, their impact on enhancing social and ecological capital is also growing in magnitude and significance.

Environmental Impact

ITC's impact on the environment as a result of its operations mainly concerns three areas: (a) release of greenhouse gases contributing to global warming; (b) consumption of water, both from surface and sub-surface sources, adding to the depletion of freshwater availability; and (c) generation of solid wastes, adding to the non-degradable waste being generated by industry.

ITC has been at the vanguard of Indian industry's attempts to minimise its environmental footprints through strategic initiatives in each of these areas of global concern.

Global Warming: In order to mitigate the effects of global warming, the Company is following a two-fold strategy: (a) reduce specific energy consumption in its operations through improved technology and processes; and (b) sequester greenhouse gases, especially carbon dioxide, through a large-scale forestry programme. These efforts have resulted in greening 41,000 hectares of land, helping ITC sequester more carbon dioxide than its operations emit. The total CO₂ released by ITC's operations in 2005-06 was 1,202 kilo tonnes while CO₂ sequestered was 1,244 kilo tonnes, or 104% of emissions. This positions ITC uniquely as a 'carbon positive' corporation. By 2010, the Company plans to green 100,000 hectares, significantly more than it would require for its expanding paperboards operations.

Solid Waste Management: Non-degradable waste is a growing menace adversely affecting the environment. Three plans are in place to reduce solid waste within the Company and make it a 'zero solid waste' company in the next two years: the major emphasis is on reduction of waste per unit of output so that the total generation of waste comes down significantly; the second step is to ensure recycling of all the wastes generated by the Company's operations; and the third step is to maximise reuse of the wastes as raw material. As a result of the first two steps during 2005-06, 78.7% of all wastes generated was recycled. ITC hopes to become a 'zero solid waste' company in the next two years through 100% recycling/reuse.

Water Conservation: ITC is mindful of the fact that freshwater in the country is increasingly becoming a valuable resource given that India accounts for 18% of the world's population but has only 4% of global freshwater resources. In order to mitigate the negative impact on freshwater depletion due to its operations, ITC has adopted a three-fold strategy: (a) minimise the consumption of fresh water per unit of output in all its businesses; (b) minimise/eliminate discharge of treated effluents to prevent damage to the environment in any way; and (c) create rainwater harvesting potential within the Company's units. Rainwater harvesting within the units has seen a significant increase between 2002-03 and 2005-06 – from 0.24 MKL to 0.61 MKL.

ITC's endeavours towards sustainability go beyond the corporate boundary. The Company has been systematically and strategically investing in creating additional rainwater harvesting capacity through external watershed development projects in water stressed areas. This was prompted by the fact that even though 70% of India's population lives in the countryside and agriculture accounts for 19% of the country's GDP, nearly 67% of the cultivated area faces

severe moisture stress for 5 to 10 months a year. From 3 projects covering 60 villages during 2001-02, ITC's watershed development projects now cover 325 villages in 16 districts, benefiting 15,506 farmers. A total of 1,011 water harvesting structures have been created. These structures provide critical irrigation to 10,277 hectares of farmland and have led to an additional storage potential of 18.99 MKL.

As a result of these measures, ITC has been a 'water positive' Company for the past four consecutive years. Compared to the net freshwater consumption of 4.62 MKL in 2005-06, the Company has created potential storage of 19.60 MKL through its water harvesting efforts both within its units and in moisture-stressed districts of the country.

The Company is keen not only to maintain its status as a 'water positive' corporation but to continue to address one of India's foremost problems – the threat of more and more areas in the country becoming moisture deficit. In the next five years therefore, the Company has planned to bring a total of 50,000 hectares under soil and moisture conservation through the creation of 1,500 additional water-harvesting structures leading to an additional potential storage of about 28 MKL.

Social impact

ITC believes that an effective growth strategy for the nation must address the needs of rural India, home to 75% of the country's poor. It is imperative to ensure that India's economic growth is inclusive, embracing its villages, so as to free millions of disadvantaged citizens from the indignity of poverty.

ITC has partnered the Indian farmer for close to a century. ITC is now engaged in elevating this partnership to a new paradigm. The ITC e-Choupal initiative is a powerful illustration of the Company's commitment to empower the small farmer and thus engender rural transformation.

ITC is also engaged in several other CSR initiatives in the economic vicinity of its operating locations. The Company's Sustainable Livelihoods initiative strives to create alternative employment for surplus labour and decrease pressure on arable land by promoting non-farm incomes. The thrust of the Company's social sector investments, christened 'Mission Sunehra Kal', is on: natural resource management, which includes wasteland, watershed, and agricultural development, creating sustainable livelihoods, comprising genetic improvement in livestock and economic empowerment of women and community development, with a focus on primary education, health and sanitation (Detailed plans

for each of the above initiatives are available in the 'Social Performance' section of this Report).

Through its rural partnerships, ITC touches the lives of nearly 4 million villagers across India. In the next 5 years, ITC aspires to empower over 10 million rural Indians.