



Himatsingka Seide Limited
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Q2 FY13 Earnings Conference Call

November 19, 2012

Moderator: A very good morning, ladies and gentlemen. I am Saurodip Sarkar, the moderator of this call. Thank you for standing by and welcome to the Himatsingka Seide Limited Second Quarter Financial Year 2013 Conference Call.

For the duration of presentation, all participants' line will be in the listening-only mode, and we will have a Q&A Session after the presentation. I would like to now hand over the conference to Mr. Amit Mishra from Macquarie Capital Securities. Over to you, sir.

Amit Mishra: Thanks, Sourodip. Good morning, everyone. It is our pleasure to host Himatsingka Seide Q2 Post Result Conference Call, and thank you very much all of you for participating on it. To represent the company, we have with us Mr. K. P. Pradeep, Group CFO; Mr. Ashutosh Halbe, AVP Corporate Finance ; and Mr. Ashok Sharma, General Manager, Treasury, Taxation and Company Secretary. Mr. Pradeep, I would now like to hand over to you for the first brief background of the results and then we will open for questions and answers. Over to you, sir.

K.P. Pradeep: Good morning, everybody. Thank you for joining the call. I would like to give you a brief summary on our second quarter results FY13. I will take you through the performance on the manufacturing division and then we go through the performance on our retail and distribution divisions. And finally we will look at the consolidated performance of the group.

For the second quarter ended September'12, our manufacturing revenues came in at Rs. 186 crores versus Rs. 160 crores during the same period last year. On a year-on-year basis, manufacturing has shown a 16.3 % growth on revenues. The EBITDA in the manufacturing division has come in at Rs. 22.25 crores for the quarter versus Rs. 21.01 crores during the same period last year. On a year-on-year basis, the EBITDA from manufacturing has shown a 5.9 % growth.

Bed Linen unit clocked 75 % capacity utilisation and the average realisation has increased by 9.3 % to Rs.322 a metre from Rs.295 per metre same quarter last year. In the Drapery and Upholstery division, average realisations have

increased by 4.8 % from Rs.1081 per metre to Rs.1132 per metre and capacity utilisation is currently at the 40% level.

So to recap on the second quarter, we closed manufacturing with Rs. 186 crores in revenue and Rs. 22.25 crores in EBITDA versus Rs. 160 crores in revenue and Rs. 21.01 crores in EBITDA during the last year.

On the distribution side of the business, we have clocked steady growth in the North American markets which includes the United States, Canada and Mexico. Our total revenue for North America during the quarter stood at Rs. 398.23 crores versus Rs. 301.74 crores last year, a growth of 32 %.

The EBITDA for the North American distribution divisions for the quarter grew 16.8% to Rs. 22.97 crores as against Rs. 19.66 crores last year. We continue to see stable demand for our brands as well as our private label businesses across the North Americas.

Through our 100% subsidiary in the Americas HIMA, we held 80% of the shareholding of Divatex Home Fashions. During the quarter we acquired additional 10% shareholding in Divatex taking our total shareholding to 90% in this division.

As regards the distribution business across India and Asia as represented by the “Atmosphere” brand, the revenues for the quarter were Rs. 12.78 crores versus Rs. 11.33 crores during the last year, a growth of 12.8 %. The EBITDA margin for the quarter was 6 % versus 10.1 % in the previous year. The drop in EBITDA margin is mainly because of increased sales to Institutional customers like hotels etc.

We continue to focus on expanding the market for this brand and with this intention we have launched an e-commerce platform during this quarter “**atmospheredirect.com**”. With this initiative, products of this brand will now be available online across 35 countries and will contribute in enhancing customer experience.

The revenues for the distribution division in Europe came in at Rs. 21.89 crores for the quarter versus Rs. 24.13 crores in the previous year. The EBITDA for the quarter was a

negative Rs. 2.13 crores as against a negative Rs. 1.08 crores in the previous year. The European demand continues to be weak. The Bellora brand continues to have a high recall and wide distribution network in their respective markets. We are in the midst of an operational plan that can address the specific requirements of this business.

For the quarter on a consolidated basis, the company clocked revenues of Rs. 472.66 crores versus Rs. 366.40 crores in the previous year, a growth of 29 %. The consolidated EBITDA for the quarter stood at Rs. 41.80 crores versus Rs. 37.75 crores in the previous year, a growth of 10.8 %. The consolidated profit, after tax and minority interest, stood at Rs. 11.48 crores for the quarter versus Rs. 10.26 crores during the previous year, a growth of 11.9 %.

The finance cost for the current quarter represents interest cost of Rs. 14.40 crores and finance charges of Rs. 2.24 crores vs 10.69 crores and 2.43 crores respectively for previous year same quarter. The interest cost of 14.40 crore for the quarter includes an amount of Rs. 2.65 crores being the notional foreign exchange differential relating to PCFC financing. As explained on earlier calls, as per the interpretation of the Accounting Standards, this is required to be disclosed as an interest cost as against a foreign exchange item. The higher interest cost is also on account of appreciation of dollar against rupee.

The total net debt outstanding as of 30th September 2012 stood at Rs. 689 crores, Rs.523 crores being term debt and 166 crores being the working capital debt. The company's effective cost of debt is 5.80 % versus 5.65 % in the previous quarter. During the half year ended 30th Sep 2012 we have repaid around 53 crores and borrowed fresh loans of Rs.50 crores. Fresh borrowings are mainly to fund the acquisition of 10% stake in Divatex.

Our overall performance is steady and our manufacturing order books continue to be strong. The manufacturing order books for the bedding division stands at around 239 crores. And on the upholstery and drapery side of the business, our order book is around 24 crores. So in total we have an order

book position of around 263 crores on the manufacturing front. Businesses across retail and distribution also continue to be steady.

We have implemented an ERP package (SAP) for the manufacturing divisions i.e both the Bed Linen and Drapery & Upholstery Divisions. We will be implementing the ERP solution in our retail division “atmosphere” in the next quarter.

As mentioned in the quarter results we settled the last remaining derivative for an amount of Rs.15.54 crores. This amount had already been provided for in the past. With this closure we have no derivative exposure. As per our risk management policy we continue to hedge our foreign currency exposures through simple forward exchange contracts.

We have seen volatility in the last quarter on the foreign exchange front. We are covered at an average rate of approximately Rs 55/- for the next two quarters.

This sums up the performance for the quarter.

For the half year our consolidated revenues were Rs.855.11 crores as against Rs.692.76 crores in the corresponding half of the previous year a growth of 23.4%. Our consolidated EBITDA was at 80.54 crores as against Rs.68.04 crores in the corresponding half of the previous year a growth of 18.4%.

The consolidated net profit for the current half year is Rs.21.88 crores vs Rs.19.81 crores in the corresponding half of the previous year a growth of 10.5%.

We continue to expect stability for the quarters ahead. We will continue to sweat our existing asset base while keeping focus on newer markets, extension of our brand portfolio and potential private label opportunities.

I would like to close with this. I will be glad to answer any questions that you may have.

Moderator:

Thank you so much, sir. With this, we are going to start with the Q&A interactive session. So I would request all

the attendees and the participants, if you wish to ask any question, please press "0" and "1" on your telephone keypad and wait for your name to be announced. I repeat, participants, if you wish to ask any question, please press "0" and "1" on your telephone keypad and wait for your name to be announced. I repeat, participants, if you wish to ask any question, please press "0" and "1" on your telephone keypad and wait for your name to be announced. Here comes the first question comes from Mr. Jal Irani from Macquarie. Mr. Irani, you can go ahead and ask your question please.

- Jal Irani:** Hi. Well, congratulations on the steadily growing performance. Looking at the results, your net sales are up quite smartly and your raw material cost has also declined. But you have a significant change in inventories which seem to have dampened earnings. I mean, basically my question is, if you have a smart increase in sales of more than 20% and also your raw material cost is down 20%, how come your profits haven't increased much more?
- K.P. Pradeep:** Hello?
- Jal Irani:** Yeah. Hello. Can you hear me?
- K.P. Pradeep:** Yeah, I can hear you. Who is this? Jal?
- Jal Irani:** Yeah, Jal. Sorry. I don't know if you heard my question?
- K.P. Pradeep:** Your question is vis-à-vis sale and stability on raw material prices, why the drop in profitability relatively speaking.
- Jal Irani:** There is an increase in profitability but the profit increase does not fully reflect both the sharp drop in raw material cost and also sharp increase in sales turnover.
- K.P. Pradeep:** To get the full extent of the material cost you have to aggregate cost of materials, purchases and inventories. The single largest causative factor however is loss on foreign exchange fluctuation of 6 to 7 crores. That has effectively dropped profitability to that extent. If you adjust for this, you will probably see that it could have been a much better performance than it has been.

- Jal Irani:** So the 6 to 7 crores of loss of profit due to forex fluctuation, would that floor down straight to profit before tax?
- K.P. Pradeep:** That's right.
- Jal Irani:** Okay. And your order book position, you mentioned this 200 odd crores, right? I forget how much.
- K.P. Pradeep:** Our order position is 263 crores of which the bedding division is at 239 crores, and the upholstery and drapery business is at 24 crores.
- Jal Irani:** Okay. So how does this compare to the previous year?
- K.P. Pradeep:** I should say this is higher than the previous year. You are talking about September 11, right?
- Jal Irani:** Yes, the comparable period.
- K.P. Pradeep:** That is right. It will be at least 10% higher.
- Jal Irani:** Okay. And how does the profitability look on that? Is that a sort of similar profitability as in the previous year or is there any likely change?
- K.P. Pradeep:** You can expect stable performance.
- Jal Irani:** Sure. You mentioned utilisation rates are secured for which assets? I mean one is 40% odd and the other is some 80% odd, what is the scope for increase?
- K.P. Pradeep:** In the bed linen unit, we are at 75% capacity utilisation and in the drapery and upholstery division, we are at 40%.
- Jal Irani:** What is the scope of increase? I mean given high fixed cost base, would not that increase in turnover increase profits, sort of have an operational leverage effect on profits?
- K.P. Pradeep:** Absolutely. I mean the initiatives are to address continued sweating of our assets. Bed linen has been clocking better capacity utilisation. We have also done a bit of debottlenecking in the bed linen plant and capacity has been re-rated in certain blocks and as a result of which on slightly enhanced capacity we are in the region of 75% capacity utilization. In the drapery and upholstery division,

we are at 40%. Could it be better ? Yes, we would like it to come back to the 75% capacity utilisation that it was, and all our efforts are to get there. And you are right, to the extent that you keep enhancing the utilisation vis-à-vis capacity, you should see better performance on the bottom line. The numbers here reflect what is potentially possible going forward.

Jal Irani: Sir, going back to my first question, your profit before tax for the quarter was Rs. 14.77 crores, right? And if you add back, you said 6 to 7 crores of forex loss, because of fluctuation, so if one adds back say 6.5 crores, I mean I am just wondering am I doing the right calculation?

K.P. Pradeep: You get the figure of Rs. 21 crores.

Jal Irani: Rs. 21 odd crores, which is then a year-on-year, which is a sequential growth of nearly... I mean profits have nearly doubled basically, sequentially.

K.P. Pradeep: In a manner of speaking, yes. But the fact of the matter is you can never completely undo the impact of forex given the fact we have a risk management policy that address the foreign exchange movement in a particular fashion.

Jal Irani: Sure. Okay, my point is I mean as you mentioned, one can never figure that out. So on a normalised basis, I mean assuming that over the longer term it evens out the forex loss and profit, I mean one has to simply look at it on a normalised basis, and therefore on a normalized basis if one strips out the forex loss, then the profits are nearly doubled.

K.P. Pradeep: Yes in theory, though stripping out the forex is a hypothetical situation as I see it.

Jal Irani: Sure. That is all from me. Thank you.

Moderator: Thank you, Mr. Irani. The next question is from Mr. Bharat Seth from Quest Investment. Mr. Seth, you can go ahead and ask your question please.

Bharat Seth: Hi, on this forex loss, is it because of a mark-to-market or is it actual loss that we have incurred?

K.P. Pradeep: It is not a mark-to-market forex loss. It is the combination of loss realised on transactions that have been executed

during a particular quarter and translational exposures given that you are reporting in a currency other than the transacted currency.

Bharat Seth: Okay. So how much is that, I mean, out of this 9 crores in the restatement of forex closing rate?

K.P. Pradeep: You could put it in a ratio of around 60:40.

Bharat Seth: Okay.

K.P. Pradeep: 60 in terms of the realised loss on actual booking on sales and 40% on translations.

Bharat Seth: On top line, how much growth has been thanks to because of this higher Rupee depreciation, how much can you attribute to that? Because of one is restatement I mean of US sales converted into Rupee, then second thing is on manufacturing side, how much because of that additional we have got?

K.P. Pradeep: You could take roughly 8% on account of growth, and the remaining on account of exchange.

Bharat Seth: Can you repeat, sir?

K.P. Pradeep: 8% on account of growth and the remaining on account of exchange.

Bharat Seth: Okay. And on this other operating income which has shot up substantially, so is it one time or it is a recurring shot?

K.P. Pradeep: We have a captive power plant at Hassan which from time to time has excess power to sell to the grid or merchant power. This quarter, there was a good demand from merchant power given the power situation. The higher operating income is largely a reflection of this.

Bharat Seth: And what rate do we sell to merchant rate or to the grid?

K.P. Pradeep: It is a varying sort a rate, Bharat, and will be anywhere between Rs. 5 to sometimes even Rs. 11 to Rs.12. On an average, we should see in the region of around Rs. 6.5 to Rs. 7.

Bharat Seth: Okay. And going ahead, how do you see that continue in the second half?

K.P. Pradeep: It is a seasonal sort of thing. This is the first time that in this quarter we have had so much of power sale. We have never had equivalent in the same quarter of the last year. But given the situation in the state and given what we are witnessing in terms of power cuts, I am starting to believe that this could be fairly constant as we go forward.

Bharat Seth: Okay. And what was the reason for decline in the utilisation rate of this upholstery division, which we were... I mean I believe last year we were around 50% kind, correct? And we were looking to improve that realization.

K.P. Pradeep: That is true. As you are aware, Bharat, there was the recession which for the first time impacted the luxury segment of the business. The drapery and upholstery division given that it caters to the luxury end of the business dropped down in capacity utilisation. We are at the 40% level at the moment. It is true that consumer behaviour in this segment has changed post the recession. There is a lot of emphasis on product innovation and other technical aspects related to product. Also it is interesting to note that we manufacture silk and silk blended fabrics. It is a combination of various fibres which includes linen, cotton, polyester etc.

Bharat Seth: So what is the strategy to really improve that because that will be the key to improve our profitability over a longer term, correct?

K.P. Pradeep: The drapery and upholstery manufacturing division is an important segment in our overall profitability. Newer product offerings by way of product innovation, product category expansion, a continued emphasis on newer markets and new customer acquisition within the existing markets will drive our business going forward.

Bharat Seth: But currently, I mean Atmosphere has contributed to our sales of drapery and bed linen.

K.P. Pradeep: Sorry, could you repeat the question, please?

- Bharat Seth:** I mean out of whatever manufacturing we are doing, how much we are marketing it to Atmosphere?
- K.P. Pradeep:** Today the ratio is around 70:30. 70% is exports and 30% is to our retail subsidiary from the drapery and upholstery manufacturing plant.
- Bharat Seth:** It is same. I mean, 30% is for drapery also as well as 30% is for bed linen?
- K.P. Pradeep:** No. From the drapery upholstery manufacturing division, 70% is for exports direct to North America, Europe and rest of the world and we also sell 30% to our retail subsidiary, which is Himatsingka Wovens Private Limited the Atmosphere side of the business.
- Bharat Seth:** And now going ahead, how do you see with some kind of... I mean, election in US is getting over and all, and Europe is [unclear]. So demand on upholstery, do you see any momentum on that side?
- K.P. Pradeep:** There are two distinct aspects of the drapery and Upholstery side of the business. One relates to new launches of products and the other relates to reorders on prior launches. These are timed across various quarters. So the new launches have happened. We will have to wait and watch as to how the market reacts to these launches basis which we will see reorders. I do not see any huge impact from the changes that you are mentioning in the US and Europe, on the Drapery and Upholstery side of the business. But I believe, given our continued focus on product we should strike the right chord in our markets.
- Bharat Seth:** You stated that in this quarter around 2.6 crores is on account of the interest cost including exchange loss. Although our borrowing has come down, so half-year around five crores exchange loss is included in interest cost. But still although borrowing has gone down, why our interest cost is increasing?
- K.P. Pradeep:** Okay. Let me give you a breakdown. If you look at our 30th September 2012 situation, we have an interest cost of Rs. 32.98 crores. If you look at the position as of September 2011, you will see an interest cost of Rs. 23.96 crores. We have had certain onetime upfront cost on account of refinancing of roughly around Rs. 1.5 crores, we have a

PCFC -- I was discussing this on the last conference call about the PCFC cost that will require disclosure as an interest cost - because of a change in the accounting standards, and that is around four crores. Apart from this fact that there is an exchange impact of roughly around Rs. 1.5 crores, because we accrue interest on account of loans taken in our subsidiaries out of India. From September '11 to September '12, the USD INR exchange rate has moved up by around Rs. 10. It was Rs. 44 in September '11 and it has moved up to Rs. 54 in September 12 on average. So if you sum up it accounts for the increase .

Bharat Seth: Okay. Thank you. That is all from my side.

Moderator: Thank you, Mr. Seth. I would like to repeat once again to all the attendees and the participants, if you wish to ask any question please press "0" and "1" on your telephone keypad and wait for your name to be announced. I repeat, participants, if you wish to ask any question, please "0" and "1" on your telephone keypad and wait for your name to be announced. And here comes the next question from Jal Irani once again from Macquarie. Mr. Irani, you can go ahead and ask your question, your line has been unmuted.

Jal Irani: Hi, again. One firstly a follow-up question, you mentioned that bulk of the top-line increase is due to forex, I mean, essentially Rupee depreciating, that would be true I would imagine year on year, so over September '11. But June 12 also you had a very smart increase in turnover of more than 20%. And if I am not mistaken, the currency perhaps has even mildly appreciated. So what would you attribute the sharp increase of over June quarter 2012? I mean, presumably, this is really a combination of both volume increase and underlying price realisation which has got nothing to do with the Rupee depreciation?

K.P. Pradeep: Our North American distribution business are also clocking growth. Sequentially the topline growth has been on account of growth mainly and exchange to a lesser extent. Between June and September sequential quarter, you are right, exchange accounts for only 2 to 3 % and the rest is growth.

Jal Irani: Sure. And seasonally, is the December quarter stronger, December or even March?

K.P. Pradeep: December is a strong quarter.

Jal Irani: Okay. And if may put from a slightly longer term sort of strategic perspective, I mean, Himatsingka in the good old days used to be a 30-40% ROE company, extremely strong brand franchises, steady growth. So if I am not mistaken, net profit margin of 30% odd. At the moment your ROE is I think barely 6-7%. I do not know what your net profit margin is, perhaps 5-6%. Now, where do you see basically Himatsingka sort of strategically settling down in terms of profitability over the longer term and what do you see the roadmap to that? And the third of that question is after you are all done with sort of optimising capacities and existing brand franchises, what will be the next leg of sort of capacity expansions or [Technical difficulty] expansions beyond that?

K.P. Pradeep: Alright, let me take this question in stages.

Jal Irani: Sure.

K.P. Pradeep: Firstly, you are right. I mean, we had a very different business model in the past and Himatsingka has over the years changed its focus while continuing to grow in its industry segment which is essentially home textiles. So if we look at our businesses today, we have two manufacturing divisions, one on the drapery and upholstery side and the other one on the bed linen side. On the distribution side, our North American distribution presence is through our two subsidiaries Divatex our private label presence and DWI our branded presence, our India-Asia presence is through Atmosphere, and we have a European distribution presence with Bellora. The Distribution businesses addresses a product range that spans Drapery , Upholstery, Bed and Bath

One aspect I would like to reiterate is that our manufacturing capability is strategic. Our distribution entities collectively sell more than our manufacturing capacities can provide for. We source globally and our strategic manufacturing provides great product depth. We have a combined product and service offering for our customers which involves addressing end to end that is from sampling and design to manufacturing, logistics , warehousing and the dynamics of management at the retail point.

The quality of the Drapery and upholstery earnings which we saw for very many years started changing post the recession a few years ago. This has also been coupled with tremendous growth in our overall revenues along with product expansion in the Home textile space. Along with growth comes a broad-basing of margins. We believe that distribution will drive growth going forward. Distribution driven by private label and driven by brands. Today we have a brand portfolio comprising Calvin Klein, Barbara Berry, Espirit, Waverly, Peacock Alley and Bellora apart from Atmosphere which is our home-grown brand. All of these brands addresses markets in various geographies

What is our approach going forward? We will continue to look out for opportunities to enhance our brand presence . Also from a private label perspective, I don't know how many of you are aware ? Today Himatsingka through its subsidiary Divatex sells to 19 of the top 20 retailers in the US. So we do have fairly wide range of distribution capabilities in this market. Within private label our focus is also to move up the value chain in terms of margins and enhancing the quality of our product offerings.

We believe that India , the middle East and South East Asia is positioned well as regards an atmosphere expansion. We would like to move from 14 store presence currently in India, Southeast Asia and Middle East to around 40 stores.

All these initiatives would result in two outcomes . One is, it will continue to enhance the margin profile and from a manufacturing perspective , it also provides the right stimulus to increase capacity utilization.

Your other question on what would happen to the manufacturing units themselves, you will continue to see manufacturing providing maybe 50 to 60% of our distribution requirement. Given the distribution growth that we envisage in the business over the next two to three years, I believe there will be commensurate capacity enhancement in the manufacturing space also.

So from a longer term perspective, the vision is very clear. We will continue to keep driving our distribution strength. We have a business model which we believe works very well in this market. This has stood the test of time over the

last two to three years that we have been managing the business during a deep recession in the North American market.

We will therefore see our margins enhanced. We will see our top lines grow significantly over time. All of this will drive a higher ROE and ultimately higher shareholder value.

Jal Irani: Thank you very much.

Moderator: Thank you, Mr. Irani. I would like to repeat once again to all the attendees and the participants, if you wish to ask any question, please press “0” and “1” on your telephone keypad and wait for your name to be announced. I repeat once again, participants, if you wish to ask any more question, please press “0” and “1”. So there are no more questions from the participants. I would like to now hand over the conference to Mr. Amit Mishra for any final comments. Over to you, sir.

Amit Mishra: Mr. Pradeep, would you like to make any final comment, sir?

K.P. Pradeep: I would like to thank all the participants who have joined on this call, and we will see you on the conference call for the next quarter. Thank you.

Amit Mishra: Thank you so much, sir. It was a pleasure to have you on the call, and thank you all participants.

Moderator: Thank you so much, sir. That does conclude the conference for today. Wish you all a great day ahead. You all can disconnect your line. Thank you so much.