



# Himatsingka Seide Ltd.

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**AUDIO CONFERENCING SERVICE**

**TRANSCRIPTION REPORT**

<b>Conference</b>	Q2 FY11 Earnings Conference Call
<b>Company</b>	Himatsingka Seide Ltd.
<b>Date:</b>	November 2, 2010

**Moderator:** Thank you for standing by and welcome to Himatsingka Seide Ltd Q2 FY11 earnings conference call hosted by Macquarie Capital securities. At this time all participants are in a listen only mode. There will be a presentation followed by a question and answer session at which time if you wish to ask a question please press \* 1 on your telephone. I must advised this conference is being recorded today. I would now like to hand the conference over to Mr. Amit Mishra from Macquarie. Over to you sir.

**Amit Mishra:** Good morning everyone. It is our pleasure to host Himatsingka Seide conference call today and thank you all for joining us on the call today. We have Mr. Shrikant – Executive Director, Mr. KP Pradeep – CFO and Mr. Amit Jain – AVP, Treasury and company secretary to represent the company. To start with I would like to hand over the call to Mr. Shrikant for the brief background on the results as well as the business outlook. Over to you sir.

**Shrikant Himatsingka:** Good morning everyone, my name is Shrikant Himatsingka, I am Executive Director. I will just share a brief background to the company, some of you might already be aware and for someone new to the call this will be a little helpful. And then take you through the broad situation as far as our industry and our firm is presently today.

Himatsingka Seide is a vertically integrated home textile group as all of you are aware. The company manufactures textiles predominantly focusing on three categories of products that's curtains, upholstery, and bedding products. These manufacturing facilities are used to manufacture three categories of products and are based in Karnataka, India. We operate predominantly out of two facilities, one which is in Doddaballapur which manufactures the curtain and upholstery products with the annual capacity of approximately 2.2 million meters and other facility is located at Hassan, Karnataka. This facility is located in a SEZ and has annual capacity of 21 million meters per annum for bed-linen products.

As far as the distribution end of the business goes I will divide our distribution by geography focused on India, South East Asia, and the Middle East in our atmosphere brand which retails, upholstery and curtain products at this point. We have 14 stores in this distribution entity that is our in-house brand.

As far as Europe is concerned, in Europe through our luxury Italian brand Bellora this is focused on distributing and retailing bed-linen products across Italy and other EU countries. And as far as North America is concerned predominantly United States, Canada, and Mexico, we have our subsidiaries there. We sell through the Calvin Klein

brand, the only license for the Calvin Klein brand for United States, Canada, Mexico as well as India and also South America. We have the global license for the brand Barbara Barry. We also sell our Bellora brand in the United States and we cater to the private label programs of major retailers in the United States. So this is from manufacturing to distribution and retailing, that is our focus of business.

And as far as the last 2-3 years is concerned, all of you are aware that the company has grown significantly from approximately 150 crores to last year we ended the year with approximately 1100 crores in revenues. The growth has been led both by manufacturing and distribution of course. And we are at a very interesting point because for the last two years we had been going through the transition process where we have been investing in our acquisitions, our new facilities for bedding capacities and of course we have been challenged by the external economic environment as well, the slowdown which had obviously hit demand across our key markets. We had more recently in the past year seen unprecedented rise in the cotton prices. This has not been witnessed before. So all these factors had played a part in the transition process and the main factor that continues to linger on in terms of an external challenge is the rise in the cost of critical raw materials such as cotton yarn and silk yarn.

We intent to stay focused on building and capturing market share in all our key geographies and if you look at our quarterly results on a consolidated basis, clocked approximately 23% growth to come in at 360 crores consolidated for the quarter. This has been led by recovery in demand that we have seen especially across North America in the United States, Canada, and Mexico, these have been encouraging and we are seeing definite signs of demand recovery there.

Despite an all-time high on cotton yarn prices we have managed to increase our EBITDA by approximately 20% as well year-on-year. Our EBITDA came in at approximately Rs. 35.5 crore versus Rs. 29.6 crore last year. So it's been a year-on-year improvement of 20% but more than that on a sequential basis we came in at approximately 19 crores in EBITDA for Q1 which stood enhanced to 35.5 crores for Q2 which is also substantial improvement in EBITDA. Mind you the raw material prices continue to rise at this point and we approximately have an 8-9% of margin impact on a consolidated basis because of the prevailing raw material prices. In other words our EBITDA for the quarter which came at just a shade under 10%, 9.9% has been impacted by 8% because of the cotton and silk yarn prices that prevail in the market.

Going forward we are currently in the process of firming our plans to expand our India presence significantly. We will be rolling out our plan in terms of we will share the plan in public domain very shortly. But the contours of the plan entail a significant India presence. Our India presence is less than 5% of consolidated revenues for fiscal 10. And we see this as an immense opportunity for us to grow in the future so we are working on those plans at this point. India must contribute a significant part of consolidated revenues going forward. We have been the first mover in the luxury home textile space in India. Our Atmosphere brand vis-à-vis the retail space has been quite successful for us and we intend to significantly expand this brand and possibly even explore options of other brands in this geography.



As far as the European and United States markets are concerned, we are very well-positioned to enhance our market shares because we have already entirely integrated. Our supply chain expertise, our proximity to the market, and our ability to serve retailers through our brands and through private label programs has been tried and tested. We will continue to look at organic growth in these fronts.

For the first half ended, we've closed with a growth of 33.4 % in revenues to 661 crores and we've closed the first half with 23% growth in EBITDA to 54 crores which we feel under the circumstances once again as far as raw material is concerned is pretty interesting.

On the view as far as what raw material prices we expect going forward, clearly this is irrational. Cotton prices cannot sustain in our opinion at these levels, of course I am no commodity expert. But it's been historic high, I guess in 100 years these prices have not been witnessed. And it might even inch up few from here, I wouldn't be surprised. But eventually as a worst-case if it continues to stay at this point then this will be priced into the entire value chain. That's the worst-case option and as far as the midway scenario is concerned we expected it to correct a little bit. Will it go back to historical levels, perhaps not? That's our current view and the way we are working in the model is not based on a significant correction. The way we are working the model is based on prices remaining firm.

So from my side this is an overview as far as the company is concerned. I would like to reiterate that going forward other than organic growth in other markets we will be looking to significantly enhance our India presence such that it contributes upwards of 15-20% of consolidated revenues in the medium-term. Thank you.

**Amit Mishra:** We will open the floor for Q&A.

**Moderator:** Certainly sir. At this time participants who wish to ask a question please press \* 1 on your telephone keypad and wait for your name to be announced. If you wish to cancel your request, please press # or the pound key. First question comes from Mr. Vinay Rao from ICICI Lombard. You can go ahead sir.

**Vinay Rao:** Good morning Shrikant. I would just want you to elaborate on the footnote of the results that consolidated financial result doesn't include subsidiary of Giuseppe Bellora which is under liquidation. Can you elaborate on this liquidation part?

**Shrikant Himatsingka:** Yes, may I request CFO to do so.

**KP Pradeep:** Vinay this was the subsidiary which was liquidated last year and currently it has no impact on the financials but this note continues to appear as this is a requirement, and given the timeframe that it takes for the court process to complete in the Italian geography this will continue to appear till such time.

**Vinay Rao:** No but this liquidation means what is the current status of acquisition, what is the price you have paid and why you have done the liquidation?



**KP Pradeep:** The subsidiary was from a strategic standpoint not adding any significant value and therefore we had liquidated the subsidiary. The point is that the assets and liabilities of this subsidiary are technically at zero. So there is no impact on the financials .....is that the question.

**Shrikant Himatsingka:** But Vinay this was an inactive subsidiary of our acquired entity Giuseppe Bellora so Giuseppe Bellora of course is the entity we acquired 70% stake in as far as our Italian brand is concerned. So this acquisition of 70% stake in Giuseppe Bellora was made in February 2007 and so our co-business of European distribution and retail continues. This was a subsidiary of Giuseppe Bellora which was inactive and we just decided to wind it up as a clean up.

**Vinay Rao:** Should I ask one more question? I would want you to elaborate on your uncertain event of this derivatives position which is going to crystallize in September 2012.

**KP Pradeep:** Vinay we have one derivative the only remaining derivative. This derivative is a European option and matures on a date which is August 2012. Being a European option an event needs to occur in that particular period in August 2012. The event is not certain at this moment. On account of that uncertainty no provision has been made in accounts, and this is in line with our auditor's view.

**Vinay Rao:** And this 15.63 crores of current mark-to-market losses, how is it behaving, is it increasing?

**KP Pradeep:** Today that figure would be nearer to 12-13 crores and that's an MTM ( mark –to-market ), so you will need to see it as such.

**Vinay Rao:** And if there is no work we can unwind this position because it's and European option?

**KP Pradeep:** We could technically unwind it and we are looking at this derivative very closely as we go forward. We will take a view basis the currency situation in the market.

**Vinay Rao:** Thank you, I will come back if I have any questions.

**Moderator:** Thank you Mr. Vinay. Next question comes from Janaki Ram from Franklin Templeton. You can go ahead please.

**Janaki Ram:** Hello gentlemen. Can you give me a split of your sales, how much goes into retail/direct sales and how much you sold to institutional segment?

**Shrikant Himatsingka:** I think the appropriate segmentation would be.... most of our sales is either through our own retail channels or through retailers. So what would you like to breakup of....

**Janaki Ram:** In the sense the reason for asking this question is, what kind of pricing power do you have with your clients?

**Shrikant Himatsingka:** On annualized basis it is at approximately has 500-600 crores would be business to consumers/semi-business to consumer sales and approximately 400-500 crores of distribution sales would be more business to business kind of sales which has slightly less pricing power versus the former bucket that I spoke about. So that would be the rough breakup of sales. Of course it fluctuates quarter-to-quarter but on an annual basis 1000-1100 crores distribution revenue base that would be the split up.

**Janaki Ram:** So if you take these two segments given the fairly rapid increase in cotton prices, have you taken any pricing initiative action so far?

**Shrikant Himatsingka:** Yes in Q2 we began our initiatives on pricing. The main entities which are hit by virtue of the raw material price increases are manufacturing entities. Because they in real time absorb the cotton and silk yarn increases. But what we've done is through the chain we have approximately passed on 10-11% in constant currency pricing during the quarter, both for the curtain and upholstery segments and for the bedding segment. So ultimately our customer is paying us 10-11% higher constant currency pricing vis-à-vis what we used to.

**Janaki Ram:** Okay and this 10-11% increase has been taken for both the segments?

**Shrikant Himatsingka:** Correct. Because cotton is up 100% year-on-year in terms of prices and silk yarn is also coincidentally up approximately 110% year-on-year on prices. There is no correlation between the two commodities obviously but in both segments we have been active in passing on prices.

**Janaki Ram:** And this high cotton prices has it similarly hit your competitors as well either in this country or competitors from some other countries?

**Shrikant Himatsingka:** Well, it's bound to hit them in no uncertain terms I wouldn't know the particulars as to what they are doing to manage the increase in raw material prices. But as far as we're concerned the inflation is approximately 100% on cotton prices and as far as pricing is concerned we started to pass on 10-11% on sales which is absorbing approximately 20-25% of the raw material costs and obviously at this point there is a 65-70% exposure and that's the quantum of raw material input costs that have not been passed on. And we are working on it. Naturally the entire value chain has never witnessed this before and to increase prices 70-80% in the short span is not possible, not only for this industry but for several industries spaces. So it will be a slightly gradual affair in terms of enhancing prices, optimizing product mix, and so on. As far as competition is concerned their particular mitigation measures is something we are not aware of.

**Janaki Ram:** And so this increase in cotton prices and your expectations for future prices, has it influenced to your inventory practices?

**Shrikant Himatsingka:** Our working capital has certainly been rationalized. We've also obviously reduced our working capital requirements and we are attempting to be a much more sleek organization as far as bedding manufacturing is concerned. We are also

looking at optimizing inventories on the distribution front without impacting growth which is clearly coming through.

**Janaki Ram:** And what would be your current capacity utilization?

**Shrikant Himatsingka:** For a quarter ended September 30<sup>th</sup> we estimate it to be between 82 % and 85%.

**Janaki Ram:** You really don't have much headroom for incremental capacity utilization?

**Shrikant Himatsingka:** We are equipped to enhance the capacity in our location but with our current investment base we cannot enhance capacity in absolute terms. What we could do is optimize products mix to increase realizations from output. So our realisations per meter have gone up by approximately 25% year-on-year as far as optimally utilizing our capacities from a product mix perspective is concerned. Am I clear on that?

**Janaki Ram:** Sure, it will be more towards better quality product mix rather than higher capacity per se? And how are we coping up with this appreciating Rupee?

**Shrikant Himatsingka:** Well, KP would like to take this question?

**KP Pradeep:** There is been a 5% appreciation in the Rupee in the time period. From an effective management standpoint, we have a risk management strategy that helps us to be a little above market currently. But in longer run if this continues we would have to necessarily pass on basis the appreciation that you're seeing. More or less we've been able to mitigate this quarter basis the strategy that we have adopted on the foreign exchange management side. Also to de-risk we've also changed our sourcing mix and we have started importing raw materials to mitigate the appreciation of the rupee that we are seeing.

**Janaki Ram:** You import cotton is it?

**KP Pradeep:** We import cotton yarn now. It used to be sourced almost wholly locally and now we have shifted majority to import.

**Janaki Ram:** Okay and this single derivative that you mentioned in earlier answer, directionally if rupee appreciates will the MTM loss comedown?

**KP Pradeep:** That's right. If the rupee appreciates the MTM loss should comedown but the structures are little more complex than that. So there are other factors too.

**Janaki Ram:** Okay and my last question would be is consumer confidence in your target market, customer segments is it is back now in western countries?

**Shrikant Himatsingka:** I would say that we have seen significant recovery in sentiment clearly that is showing through in our numbers. These numbers are sort of organic growth that we are witnessing of course our business is a little seasonal and it will change from quarter-to-quarter but overall the United States has seen handsome



recovery in sentiment. We have seen that in Canada as well, we've seen that in Mexico in fact we see obviously in India very robust sentiment which we would like to capitalise on going forward. So all our brands are doing well, our Calvin Klein brand is doing well, our Barbara Barry brand, our Bellora brand, and our Atmosphere brand so all our brands are doing well and so are our private label programs.

**Janaki Ram:** You also expect the intention to grow the India business but given the local structure don't you think it going to take some time to build up branded business here?

**Shrikant Himatsingka:** Which local structure are you referring to?

**Janaki Ram:** The distribution structure where it is quite fragmented.

**Shrikant Himatsingka:** That structure in itself is the opportunity. We launched our Atmosphere brand here in 2004 so we have experience in navigating the Indian markets as far as retail is concerned. Over the years we have developed keen sense on what consumers are really looking for, the kind of profile of product, the pricing, the services, they think that they will see value in. And for us expanding the Indian presence is not going to be a very long-term affect, of course we are looking to embrace scale as far as India is concerned. The currently our revenues from India is probably only 40 crores. But like I mentioned earlier very shortly we will be unfolding our India plans in more specific detail. But conceptually we would like to take this 40 crores to 50 crores market to multiples of that value. So we don't perceive any particular issues on terms of rolling out stores, arriving at the right product, and so on, given our manufacturing, sourcing, and distribution expertise.

**Janaki Ram:** Okay so you are confident that is a market for your product here?

**Shrikant Himatsingka:** No absolutely. This is not research for us; this is a statement of fact. The market exists, it exists in a fragmented manner. Other retail segments have witnessed the same journey over the last 4-5 years. Five years ago several segments, even simple segments like grocery we have seen evolution over the last 5-6 years. Several other formats have seen it and this is one format which has not seen much of it. In fact we were the first luxury home textile brand in India. And we came in here a time where it was fragmenting; we came in at 100% premium to then prevailing market prices. We totally changed the way the consumer shops for these kinds of products as far as the demands for discounts, pricing, and for services is concerned and we had a good experience. Our retail EBITDA margins in our Atmosphere division for the first half is approximately 14-15% and we see room for growth there in terms of EBITDA margins. We see room to also be present in the new price point as far as India is concerned. So overall a lot of opportunity for India and that's going to be our focus.

**Janaki Ram:** Okay, so this Atmosphere brand is it sold through an exclusive chain for multi-brand chain?



**Shrikant Himatsingka:** Exclusive chain sir. We do not sell through multi-brand stores, and we do not sell through franchisees. The company controls exclusive stores of its own.

**Janaki Ram:** That's all from my side, all the best gentlemen.

**Moderator:** Thank you sir. Once again if you wish to ask the question please press \*1 on your telephone keypad and wait for your name to be announced. Next question comes from Mr. Siddharth from Motilal Oswal. You can go ahead sir.

**Siddharth:** Thanks, Shrikant I wanted to understand what is our cottons procurement policy? Particularly I wanted to understand where is the impact of this increase in cotton prices, is it fully reflected in our cotton numbers or were we having earlier inventory and going forward is this going to be under further pressure because now the old inventory will not be there?

**Shrikant Himatsingka:** Good question Siddharth, quarter two what you see in terms of raw material costs reflect the most recent cotton prices. So all old inventories had been exhausted and we do not carry that heavy inventory load, so what you're seeing is current prices. That's point number one. Point number two, as far as sourcing policies concerned we obviously had proximity to a large Southern spinning base for cotton spinning. We therefore didn't feel any need to have our own spinning, given its nature of heavy capital employed vis-à-vis returns. So we were very happy sourcing our cotton requirements from these mills. But because there seems to be an arbitrage between India and other manufacturers of cotton yarn, within a span of 60 days we shifted sourcing base to be able to capitalize on the arbitrage. Of course being in SEZ it helps because we are not subject to any duty and other tariffs. So our sourcing policy is, to be flexible and source from the most optimal and price effective locations and mills but we are not bound to India so to say. Obviously we have directly no exposure to raw cotton because we buy yarn. So as far as raw cotton movement is concerned we are not subject to that, we are subject to movement in yarn prices.

**Siddharth:** Just to summarize then basically unlike other companies where the full impact of your increase in cotton will only now get realized in the third and fourth quarter. In our case probably this would be the worst quarter assuming the prices stay here or will they come down going forward as the cotton how it starts hitting the market?

**Shrikant Himatsingka:** I would say Q2 prices are definitely current for us, the inflation on cotton has been weekly so it has tended to inch upwards week-on-week more than month-on-month. And I would say a rough timeframe, from the time it stabilizes so it should start showing in numbers in the following quarter. So let us say in middle of November prices start to go south or correct a little bit, the time that inventory is likely to come in and hit our P&L it will be Q4.

**Siddharth:** Absolutely and just one last question, I wanted to understand on our standalone numbers our fabric business used to have a very high margin earlier. I understand the 9% that you explained is due to the raw material but has it now structurally come down to the levels of around 18-20% or it can be hit back at the earlier levels of 30-35%?



**Shrikant Himatsingka:** 30-35% what's it sir?

**Siddharth:** Like if I remember correctly two years back we used to have 30-35% EBITDA margins for our fabric business.

**Shrikant Himatsingka:** For our curtain and upholstery segment you mean?

**Siddharth:** Absolutely. If I were to look at the same segment, if I were to exclude your cotton, if I just look at that particular segment exclude your linen segment, how would that be fairing? Is it still enjoying the same kind of profitability or that has come down?

**Shrikant Himatsingka:** The EBITDA on manufacturing segments for curtain and upholsteries came in at 22.9% for the quarter. We know that this has been entirely impacted by silk inflation.

**Siddharth:** Okay so that those margins remain the same, is that what I want to know?

**Shrikant Himatsingka:** Okay so that is for a normal silk pricing that we have seen for over two decades and since we have dealt in that businesses long enough to see these movements, the corrected EBITDA on a normalized silk pricing would be in the region of mid-30s.

**Siddharth:** Okay so that's just what I wanted to understand. Thanks so much.

**Shrikant Himatsingka:** And also Siddharth I had a point one of the things that was impacted in this global meltdown, was that the very high luxury-end products also saw a slowdown. So therefore our curtain and upholstery segment which is still high end also saw some correction on revenues and which did impact the EBITDA. But the raw material had a significant impact and hopefully we are currently seeing some revenue correction happening. We are up 6% year-on-year in terms of revenues as far as the curtain and upholstery manufacturing division is concerned and so let us see what happens going forward. At this point silk is stable, it is not seeing an inflation like cotton is. It is stable at its present levels.

**Siddharth:** Right and if I may ask one more questions, I remember when we moved into the linen segment one of the logic was that you felt you could extend your design capabilities to linen as well. And unlike other companies which were more on the commodity side, you could move up the value chain and have much higher realization as such so. I have not been up-to-date on that but how has been the progress on that objective that we had?

**Shrikant Himatsingka:** Our realizations are higher than the industry standards, number one. Number two, we have brands in our portfolio which we are catering to more and more and we are expanding these brands more and more to be able to be a greater part of the sourcing basket. So clearly that's kicking in as we speak, like I said earlier our realizations are starting to go up, of course they will vary from quarter-to-quarter but just to give you an idea for this quarter. Last year we were about \$3.98 per meter and this year in Q2 we are about \$5.5. This is not been driven only by the fact that we have done



design led product but even on the more plain products we have gone up on thread count and quality vis-à-vis product mix.

**Siddharth:** Okay so you would say you have been successful in extending your design capabilities, the objective with which you went in the linen segment?

**Shrikant Himatsingka:** Well our numbers certainly don't reflect that success to be very honest Siddharth. In terms of our standalone bed-linen manufacturing numbers for one reason or the other have not been very encouraging. But the first one and half years it was the plant stabilization itself that took a toll on the numbers and as soon as that was done and we were coming into high utilizations we got impacted by the raw material situation. Is that an excuse, no that's the truth, we believe in our philosophy that we will eventually get that value addition that we look for just like we did in silk and blended fabrics. It might take a little bit of time but eventually it will show its true color is what we believe.

**Siddharth:** Absolutely and assuming as what kind of timelines do you think it would take and what kind of margins once you achieve it, do you think this segment could enjoy?

**Shrikant Himatsingka:** Siddharth we feel that particular manufacturing divisions should have EBITDAs in the range of 22% at stable state which theoretically could be higher but we feel that optimally speaking our product mix will give us that kind of EBITDA margins.

**Siddharth:** Okay sir. Got it Shrikant, thanks so much.

**Moderator:** Thank you Mr. Siddharth. Once again if you wish to ask a question please press \*1 on your telephone keypad and wait for your name to be announced. At this time we have no further questions from the participants, I would like to hand the floor back to Mr. Amit Mishra for final remarks. Over to you sir.

**Amit Mishra:** Mr. Shrikant way you like to make any final comments.

**Shrikant Himatsingka:** I hope I have answered everyone's questions to their satisfaction. We will be more than happy to answer any queries that you might have over and above this. Please get in touch with Pradeep and Mr. Amit Jain who will answer your questions and will be in touch with all of you. Thanks.

**Amit Mishra:** Thank you sir. Thank you Mr. Pradeep and Mr. Amit Jain and thank you all participants for joining us on the call today. Thank you.

**Moderator:** Thank you sir. That does conclude our conference for today. Thank you for participating on Reliance Conference Bridge, you may all disconnect now.