Himatsingka Seide Ltd.

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AUDIO CONFERENCING SERVICE

TRANSCRIPTION REPORT

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Operator:

Thank you for standing by and welcome to the Himatsingka Seide Limited 3Q 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. Please be advised this conference is being recorded today.

I would like to hand the conference over to Mr. Amit Mishra. Over to you, sir.

Mr. Amit Mishra:

Hello everyone. This is Amit Mishra for Macquarie Capital Securities. It is our pleasure to host Himatsingka Seide third quarter post-result conference call and thank you very much all of you for participating on it.

We have with us Mr. Shrikant Himatsingka, Executive Director, Mr. K.P. Pradeep, CFO, and Mr. Amit Jain, AVP Treasury and Taxation, who will represent the company. Mr. Himatsingka, I would now like to hand over to you for first brief background to the results followed by question and answer session. Over to you, sir.

Mr. Shrikant Himatsingka:

Good morning everyone. I thought I will take you through the broad outlines of the results first and then we will be happy to answer any questions that you might have.

I will begin with the consolidated results for the 9 month ended 31st December. Total revenues were up at Rs.952 crores which showed an increase of 21.6% year on year versus Rs.783 crores during the 9 months ended last financial year. EBITDA for the 9-month period came in at Rs.74 crores versus Rs.72.5 crores during the 9 month period last year. So, the EBITDA have remained range bound during this period in spite of the increase in revenues. The net profit after tax came in at a net loss of Rs.5.06 crores for the 9-month period December 31st, 2010, versus net profit after tax of Rs.17.4 crores during the last financial year.

The consolidated revenues reflect the strong growth we continue to see in the North American markets and we have also seen growth during the 9-month period in our manufacturing revenues although in Q3 they have come down a little bit year on year and we will take you through the reasons why.

On a 9-month basis, our performance in North America the total revenues stood at Rs.722 crores for the 9-month period ended versus Rs.579 crores during the last year, which represents a growth of 24.7% year on year. EBITDA in North America have increased 154% to Rs.46.7 crores versus Rs.18.3 crores during the last financial year. Pretax earnings have gone up by 250% to Rs.39.5 crores versus Rs.11.3 crores during the last financial year. So, the two companies in North America are Divatex and DWI Holdings and I am giving you a combined North American performance which is what I just stated.

On the performance in Europe as far as distribution is concerned, the European subsidiary Bellora has held steady performance during the 9-month period. The total revenues have come in at Rs.80 crores versus Rs.92 crores during the last year. However, this 13% dip in revenues in Europe are only a function of exchange rate fluctuation as in terms of constant currency in Euro the 9-month sale has come in at 13.46 million Euro versus 13.6 million Euro the last year. So, Euro sales have held steady, it is only the exchange rate vis-à-vis the Euro that has caused correction on the translated rupee version. So, cumulative sales for the 9-month period came in at Rs.80 crores versus Rs.92 crores. EBITDA came in at positive Rs.45 lakhs for the 9-month period versus negative EBITDA of Rs.1.9 crores, and profit before tax came in at a negative Rs.3.9 crores versus a negative Rs.6.4 crores during the last financial year.

So, we have seen operating improvements in our Italian subsidiary despite the adverse conditions prevailing in those geographies at this point. As far as Asia is concerned which is Himatsingka Wovens, our 9-month performance has come in at Rs.36.5 crores versus Rs.39.15 crores during the last year. This 6.7% reduction is broken up as follows. We have deduction in other operating income in the subsidiary because it has stopped certain manufacturing activities related to cutting and sewing which has been shifted to the Hassan facility and therefore other operating income has come down from Rs.5 crores to Rs.3.7 crores. However, retail revenues have pretty much remained steady during the 9-month period. Last year it came in at Rs.34.13 crores, this year it has come in at Rs.32.8 crores. So, retail is range bound and stable, and the reduction really reflects the reduction in other operating income. The EBITDA for 9-month period came in at 16% like last year at Rs.5.76 crores and pretax earnings came in at Rs.1 crore for the 9-month period.

On the manufacturing front, if I look at the 9-month performance of manufacturing which is the combination of Himatsingka Seide and Himatsingka Linens, total revenues came in at Rs.411 crores versus Rs.338 crores last year, which is an increase of 21%. EBITDA during the period have reduced to Rs.22.7 crores from Rs.54 crores during the last financial year, and the profit before tax came in at a negative Rs.27.3 crores versus a PBT of Rs.19.8 crores during the last financial year. We must keep in mind that during the last financial year the Rs.19.8 crores profit before tax also reflected an exceptional item of Rs.8.5 crores gain for that period. So, these are the broad segments.

Once again, while on consolidated revenues we came in at Rs.952 crores and EBITDA came in at Rs.74 crores for 9 months, the US came in at Rs.722 crores and Rs.46.7 crores in terms of revenues and EBITDA; Europe came in at Rs.80 crores and flat on EBITDA Rs.45 lakhs; Asia came in at Rs.36 crores and EBITDA of Rs.5.7; manufacturing came in at Rs.411 crores and EBITDA of Rs.22.7 crores. The impact on the consolidated results are really coming from one division alone, which is the Himatsingka Linens division, the bedding division. The impact of cotton prices has been absolutely adverse and unprecedented, and I am sure you are aware of the events that transpire on the cotton front. Our estimated impact for the 9-month period on raw material is approximately Rs.90 crores on the EBITDA level and have hurt our operating margins by approximately 8 to 9% during this period.

In terms of company's actions to mitigate this cost pressure on the input front, it has been increasing its prices beginning of Q2, some of it is reflected in Q3, some will start reflecting in later parts of Q4 depending on the agreement we have had with our customers. The total quantum of price increases that we have clocked on the bedding division has been approximately 28% now and we are moving into the next round of price increases which should be in the region of 12-15%.

I will give you a quick breakup of the operating performance in manufacturing and that should give you the right idea of how things are looking on the manufacturing front. Our silk SBU, which is Himatsingka Seide, clocked 9-month performance of Rs.85 crores versus Rs.77 crores during the last year, a growth in revenues of 10%, and it has clocked an EBITDA of Rs.18.3 crores versus Rs.23.1 crores during the last financial year, which is a decline of 21%, and pretax earnings have come in for the silk division at Rs.10.8 crores versus Rs.13.8 crores during the last financial year. The EBITDA for 9 months are at 22% versus 30% during the last financial year, and once again the impact here although it is much lower in intensity than the bedding division has come in from the serious inflation we have seen on silk yarn prices during the last year. Our raw material percentage in the silk division for the 9-month period stands at 39% for the entire division versus 31.3% clocked during the last financial year, and this really reflects the inflation we have seen on silk yarn. The total inflation has been 120%, little higher than that actually, yarn prices were in the region of 22 to 23 dollars per kilo last year which today stands at 51 to 52 dollars a kilo. So that is the 120% we have seen in the silk. However, clearly a lot of it has been passed on and we have contained the raw material percentage to 39% despite this steep increase. Once again we are in the process of passing on the prices to our customers which should hopefully in the next couple of quarters take the raw material percentage back in the region of 30% in the silk division.

As far as the bed linen division is concerned, the total sales have come in at Rs.326 crores for the 9-month period versus Rs.262 crores during the last year, a growth of 25%. However, EBITDA have come down to Rs.4.5 crores versus Rs.32.5 crores clocked during the last financial year, and the pretax earnings have come in at a negative Rs.40 crores because of the impact on raw material.

I hope this gives you a picture in terms of where the damage on consolidated financial performance is actually coming from. Our North American distribution, our silk division, our Asia distribution, and our Europe distribution are clocking fairly stable performances. US is looking positive along with Canada and Mexico and also South American markets. So, the challenge in front of the company remains the cotton prices and the silk prices, both of which are currently being passed on to our customers and hopefully this exercise shall stand completed in the next 4-6 months. There are no other fundamental changes in outlook as we see it. Demand continues to be stable. We have not opened any new stores during the quarter or during the 9-month period which is why the retail revenues have sort of stabilized at these levels. We have passed on increases in prices to end consumers on the retail front given the input cost increases. The average realization for the period is up by approximately 250 to 300 rupees to 2000 rupees in India and upwards of 2500 rupees in the Middle East and close to 3000 rupees in Singapore. This is as a result of price increases that we have passed on.

All in all, we look to clock approximately Rs.1150 crores to Rs.1200 crores during this financial year as we had started out with. So, we remain firm on our outlook on the consolidated revenues for FY11, and as far as the operating performance goes other than the raw material inflation, we do not see any other significant movements at this point. Over to you, please.

Operator:

Shall we start with the Q&A sir?

Mr. Amit Mishra:

Sure.

Operator:

Thank you sir.

At this time, if you 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 hash or the pound key.

First in line, we have Mr. Prakash Ramasheshan from Kotak Mahindra. You may go ahead please.

Mr. Prakash Ramasheshan:

Good morning sir. Thank you for that overview. Just trying to understand the three parts of the business. If I look at the erstwhile silk business which used to be basically exports of fabrics to world wide markets, how is the top line there, if I look at atmosphere, how is the top line there, and if I look at the bed-linen business how is the top line there, and where do you expect the growth to come from, and that is the first question that I have.

Mr. Shrikant Himatsingka:

Okay. May I go ahead and answer that?

Mr. Prakash Ramasheshan:

Yes, please sir.

Mr. Shrikant Himatsingka:

The performance on our legacy silk business, as far as the top line is concerned, the top line for the quarter came in at Rs.30.6 crores versus Rs.25.3 crores last year, a growth of 21%, and for 9-month period the top line came in at Rs.85 crores versus Rs.77 crores, a growth of 10.5%. As far as bedding is concerned, for the 9-month period, the sales came in at Rs.326 crores versus Rs.262 crores, a growth of 24.7%, and as far as the quarter on bedding is concerned, the top line came in at Rs.80 crores versus Rs.116 crores, a degrowth.

Mr. Prakash Ramasheshan:

What was the last number sir, apologies?

Mr. Shrikant Himatsingka:

The last number was on the bed-linen 9-month which came in at Rs.326 crores versus Rs.262 crores, which is 24.7% increase. And for the quarter, the bedding revenues came in at Rs.80 crores versus Rs.116 crores during the last year, which is a degrowth of 31%, that is really because we have for a period of approximately 14 to 16 weeks reduced output just to sort of tackle the cotton prices, we have been very selective on our orders and that should go back to normal levels by the Q1 of next financial year.

Mr. Prakash Ramasheshan:

Fair enough.

Mr. Shrikant Himatsingka:

As far as atmosphere is concerned, which is our India-Asia retail platform, revenues for 9 months it came in at Rs.36.5 crores versus Rs.39 crores during the last year, but that as I said earlier is a reduction in other operating income which has really caused the reduction. Retails revenues for the 9-month period came in at Rs.32.7 crores versus Rs.34.13 crores, so it has largely remained stable, but we have not opened any new stores during this period.

As we see growth going forward, we have announced our plans to expand our retail network both on the atmosphere front and launching a new brand with mid tier price points in mind. So, going forward we will be clearly focusing on growing our retail business, our retail EBITDA performance has come in at 16% which we believe is very healthy. The EBITDA for the quarter has come in at 17.8% on the retail front, it is a profitable division for us even at this size and we see scaling up the retail business going forward. We had announced our plans of opening 170 stores in all on the retail front from the current 14 stores that we operate over the next 2 to 3 years. The other growth area that we see is largely organic which is coming from our deep presence in the North American markets where we are seeing a good traction across United States, Canada, Mexico, and other South American markets.

Mr. Prakash Ramasheshan:

That is basically the bedding and the linen business?

Mr. Shrikant Himatsingka:

Yes, and as far as manufacturing is concerned, we have come in at Rs.411 crores for the 9-month period versus Rs.338 crores during the last year and the potential on the manufacturing side without adding any capacity is 650 to 700 crores in top line. The manufacturing divisions currently are clocking a very low EBITDA given the raw material inflation, but as I said prices are being passed on, we are in the mid to high range of the market, we have a large number of brands in our portfolio but despite that it might take us a few months to pass on prices. Post which at stable state in manufacturing we expect EBITDA to be stable at around 24 to 25% for both units put together.

Mr. Prakash Ramasheshan:

Sir, just correct me if I am wrong. If I look at the legacy silk business with some lag you should be able to pass on cost there, because you are a great quality manufacturer of silk fabric and the atmosphere business you actually own the brand yourself and it is actually profitable at this level. So, if I look at the challenges in the business, would I be right to say that one challenge you have is the fact that you are manufacturing capacity utilizations are not where they can be. Secondly, you have had problems with raw material price volatility and inflation which you are passing on over time, and thirdly the price that you have paid for the various brands globally has still to yield the revenues necessary, is that right?

Mr. Shrikant Himatsingka:

I would agree with your second point on raw material, that is definitely a challenge for us and we are passing on the prices. As far as the utilizations are concerned, both the divisions are looking to clock higher utilizations going forward. So, that challenge is something we can definitely mitigate, but we want to do it at the right prices, so we are just taking a little time. As far as our acquisitions are concerned, at least after the global slowdown and so on finally they have started to perform like I said our North American acquisitions which were really the two major acquisitions we made have clocked a substantial improvement in performance. If I look at FY09 combined results from our revenue base of 154 million and a EBITDA of 1.6 in FY10 they climbed revenues to 169 million, the EBITDA climbed to 5.2, and for the 9-month period FY11, the sales have climbed to 158 million for the 9-month period and EBITDA at 10.3. We expect to close this year in the region of 195 to 200 million versus 169 million last year, and our EBITDA should be in the region of close to 12 to 13 million dollars for FY11. So, we see good traction and we think our brands are giving us what we expected them to.

Mr. Prakash Ramasheshan:

But just to understand sir how much did you pay for these brands at that time?

Mr. Shrikant Himatsingka:

Both the companies we paid 350 crores. We bought them at that time prior to the slowdown we bought them on a one-year forward EBITDA of 5.5 times.

Mr. Prakash Ramasheshan:

Yes, sir, basically it is about 75 million dollars?

Mr. Shrikant Himatsingka:

Yes, and this year we are at approximately …..

Mr. Prakash Ramasheshan:

Yes sir, 75 divided by 13, you are basically at about 5.5 times EBITDA, which is not a bad value sir. I think it is slowly getting to a position where it is now proving that the price you paid then was worth while for the acquisition. The challenge has been the global slowdown and now the numbers are coming back.

Mr. Shrikant Himatsingka:

Yes, if I back out from my 9 months results, if I back out the impact of the bed-linen division, we will clock profits of close to 45 to 50 crores for the 9-month period.

Mr. Prakash Ramasheshan:

How does that work sir, the bed-line and negatives are coming in there you are saying.

Mr. Shrikant Himatsingka:

Yes, on a consolidated basis, the manufacturing part of bedding because of the cotton prices has impacted consolidated financial performance.

Mr. Prakash Ramasheshan:

Fair enough, otherwise your number should be more like 15 to 16 million dollars for the year?

Mr. Shrikant Himatsingka:

Yes, because for the 9-month period, our North American business has given a top line of 722 crores, a growth of 25%, and pretax earnings for North America come in at 39.7 crores, so 40 crores, and our silk division has earned 10 crores during the quarter and retail has also pitched in. So, basically, it is a bed-line manufacturing division alone out of six businesses which is causing the current impact on consolidated financial performance.

Mr. Prakash Ramasheshan:

One last question sir, and I will let the other people participate, any disclosures on contingents and any developments on those or basically we are saying that all liabilities are right now on the balance sheet?

Mr. Shrikant Himatsingka:

All liabilities other than the foreign exchange derivative which is disclosed as far as notes to accounts in our published results, other than that everything is on the balance sheet and every quarter we disclose . . .

Mr. Prakash Ramasheshan:

And what is the status on the derivatives?

Mr. Shrikant Himatsingka:

There is only one derivative open, I mean there was only one derivative the company has for which it is stated it is marked to market as of 31st December, which stood at 18.6 crores.

Mr. Prakash Ramasheshan:

Okay.

Mr. Shrikant Himatsingka:

That is it.

Mr. Prakash Ramasheshan:

So, this is the potential derivative negative, is that right?

Mr. Shrikant Himatsingka:

That is right. This has not been provided for.

Mr. Prakash Ramasheshan:

Okay. Thank you sir. Thank you very much.

Mr. Shrikant Himatsingka:

Thank you.

Operator:

Thank you sir. Once again, if you wish to ask a question, please press *1 on your telephone and wait for your name to be announced.

At this time, there are 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.

Mr. Amit Mishra:

Thank you very much Mr. Himatsingka. Would you like to make any final comment?

Mr. Shrikant Himatsingka:

Not really.

Mr. Amit Mishra:

Sure. So, thank you all for participating on the call. It was pleasure to host you today. Thank you very much.

Mr. Shrikant Himatsingka:

Thank you, bye.

Operator:

Thank you sir. That does conclude our conference for today. Thank you for participating on Reliance conference bridge. You may all disconnect now.