Himatsingka Seide Limited

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Q1 FY13 Earnings Conference Call

August 13, 2012

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

For the duration of presentation, announcement: all participants' line will be in the listen-only mode, and there will be a brief highlight of the quarterly results which will be followed by a question-and-answer session. I would like to now handover the conference to Mr. Amit Mishra from Macquarie Capital Securities. Over to you, sir.

Amit Mishra: Good morning, everyone. It is our pleasure to host Himatsingka Seide Q1 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 Accounts, and Mr. Ashok Sharma, GM Treasury, Taxation and Company Secretary. Mr. Pradeep, I would now like to handover to you for the first brief background to the results and then followed by questions and answers. Over to you, sir.

K.P. Pradeep: Thank you, Amit. And good morning everybody. Thank you for joining the call. I would like to give you a brief summary on our First Quarter Results FY13. As usual, I will take you through on the performance on the manufacturing divisions and then we will go through the performance on our retail and distribution divisions, and finally we will look at the consolidated performance of the group.

For the first quarter ended June 12, our manufacturing revenues came at Rs. 163 crores versus Rs. 158 crores during the same period last year. On a year-on-year basis, manufacturing has shown a steady performance growing approximately 2.7% on revenues. The EBITDA in the manufacturing division has come in at Rs. 27.63 crores for the quarter versus Rs. 17.84 crores during the same period last year. On a year-on-year basis, the EBITDA from manufacturing has shown a 54.9% growth. The EBITDA margin for the quarter was 17% as against 11.3% in the previous year.

I will go through the reason briefly. The improvement in the EBITDA in our manufacturing business has been on account of the improved product mix at our drapery upholstery and bedding manufacturing division which has consequently enhanced realisation. At the bed linen plant, the average realisation has increased by 17%, to Rs. 322 a metre from Rs. 276 per metre in the same quarter of the last year. In the drapery and upholstery division, average realisations have increased by 6.5%, from Rs. 1081 per metre to Rs. 1151 per metre, an increase of 6.5%.

So to recap on the first quarter, we closed manufacturing with Rs. 163 crores in revenue and Rs. 27.63-crore in EBITDA, versus Rs. 158 crores in revenue and Rs. 18 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 United States, Canada, and Mexico. Our total revenue from North America during the quarter stood at Rs. 316.52 crores versus Rs. 256.15 crores last year, a growth of 23.6%.

The Divatex division which addresses the private label business grew 17%, to Rs. 226.52 crores versus Rs. 194.35 crores last year. Our DWI division which is in the branded side of the business grew to Rs. 89.60 crore versus Rs. 60.36 crores last year, a growth of around 48%. The EBITDA for the North American distribution divisions have been stable for the quarter at Rs. 11.35 crores as against Rs. 11.83 crores last year. The EBITDA margin is at 3.6% for the quarter.

We continue to see stable demands for our brands as well as our private label business across the North Americas. We have recently signed up a licence for another brand in the United States “Peacock Alley”. We expect this to add to our branded presence in the North American markets. With this, the group has seven brands within its portfolio of brands. These brands include Calvin Klein, Barbara Barry, Peacock Alley, Espirit, Waverly, Bellora, and Atmosphere.

As regards the distribution business across India and Asia, as represented by the Atmosphere brand revenue for the quarter was Rs. 13.12 crores versus Rs. 11.7 crore during the last year, a growth of 12.2%. The EBITDA margin for the quarter was 17.3% versus roughly the same in the previous year.

The revenues of the distribution division in Europe came in at Rs. 22.42 crores for the quarter versus R.s 26.88 crores in the previous year. The EBITDA for the quarter is negative at Rs. 3.19 crores as against the negative of Rs. 70 lakhs in the previous year. The European demand continues to be weak, and we have seen de-growth in revenue in this division. We expect to see continuing headwinds this financial. We anticipate that recovery in this division will take some more time.

On a consolidated basis, the company clocked revenues of Rs. 382.45 crore versus R.s 326.35 crores in the previous year, a growth of 17.9%. The consolidated EBITDA for the quarter stood at Rs. 38.74 crores versus Rs. 30.29 crores in the previous year, a growth of 28% roughly. The EBITDA margins stood at 10.1% for the quarter versus 9.3% in the previous year. The consolidated Profit After Tax and minority interest stood at Rs. 10.4 crores for the quarter versus Rs. 9.55 during the previous year, a growth of 8.9%. This sums up the consolidated quarter performance.

The finance cost that you see represents an interest cost of Rs. 14.03 crores and finance charges of Rs. 2.31 crores. And the interest cost of Rs. 14.03 crores for the quarter include an amount of Rs. 2.65 crores being the notional foreign exchange differential relating to PCFC financing. As per the revised Schedule VI read with accounting standard 16, this is required to be disclosed as interest cost. Apart from the above, the higher interest cost has also been on account of foreign exchange translation of around Rs. 85 lakhs.

So the total net debt outstanding as of 30th June, 2012 is at Rs. 695 crores. The company's effective cost of debt is 5.65% versus 5.74% in the previous quarter the decrease in cost reflecting the change in financing mix on our working capital financing.

Our net worth as on 30th June is at Rs. 568 crores. On the raw material front, we did see some volatility in the last quarter. However, we have mitigated it to some extent with some raw material cover, and also enhanced exchange realizations.

Our overall performance is steady. Our manufacturing order books continue to be strong. The manufacturing order books for the bedding division stands at around Rs. 193 crores and for the upholstery and drapery side of the business, our order book is around Rs. 16 crores. So in total, our order book position is around Rs. 209 crores on the manufacturing front.

We have seen volatility in the last quarter on the foreign exchange front. We cover our foreign exchange inflows and outflows in line with our risk management policy. On the foreign exchange front, we have are covered at an average rate of around Rs. 53.50 to a dollar.

As you are aware, there is one derivative for which we have already made provision in accounts. The MTM for the same as of 30th June 2012 has been provided for at 18.24 crores. This last derivative crystallised on 9th August, 2012, a few days ago at 15.54 crores. The impact of this will be reflected in the Q2 FY13.

As you can see, there has been a positive swing for the performance for the quarter ending 30th June, '12 as against the same quarter of last year. And this in total sums up the performance for the quarter for the group. Going forward, we will continue to focus on our operating performance through various initiatives. We will continue to grow our branded and private label presence. While the macroeconomic environment appears mixed depending on the geography that one would look at, we expect stability in our performance as we go forward.

I would like to close with this, and I will be glad to take 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 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 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. And the first question comes from Sameer Raj from Reliance Mutual Fund. Mr. Raj, you can go ahead and ask your question, please.

Sameer Raj: Good morning. Just wanted your thoughts on – your outlook for the current year to be stable, and performance is improving steadily, so what are the plans to use the cash flows which you are going to generate?

K.P. Pradeep: Sorry, what are the?

Sameer Raj: What are the plans to use the cash flows which you are going to generate?

K.P. Pradeep: Sameer, we do have debt repayments currently on account of principal and interest. You would see debt reduce at a steady pace. That will be the focus as we go forward too. We would have CapEx in the normal course which is anywhere between Rs. 10-15 crores for a plant of this size.

Sameer Raj: Overall, any targets on the debt reduction?

K.P. Pradeep: We have debt repayments on principal account of around Rs. 50 crores every year. This reduction should reflect in the debt outstanding going forward. As you will notice our debt has a mix of debt taken in the overseas subsidiaries. You will of course have to adjust such debt for translation differences. These would have only translation impact and not necessarily a cash flow impact.

Sameer Raj: Okay. And overall if one takes a three-year view, from where you see the growth coming from?

K.P. Pradeep: The growth will definitely come from our North American markets. In these markets we continue to developing new customers in private label as well as enhance our presence in the branded portfolio space through acquiring licenses. As part of this initiative, we have recently acquired the license of the luxury branded Peacock Alley. As we have mentioned in the past we would be looking at the Indian market to enhance our presence in the retail side, represented through our Atmosphere brand.

Sameer Raj: Okay. And lastly, any thoughts on dividend policy you would want to follow as the performance stabilizes.

K.P. Pradeep: We would like to adopt the same policy as in the past. As performance stabilises going forward, you could see dividend pay-out reflecting the way we have done in the past.

Sameer Raj: So basically you would want to go back to our past payout ratio which we used to have when we [Multiple Speakers] performance?

K.P. Pradeep: Yes, that would be the target.

Sameer Raj: Great, sir. That is all from my side. All the best. Thanks.

K.P. Pradeep: Thank you.

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

Bharat Seth: Good morning, sir. And congratulations on a good set of numbers.

K.P. Pradeep: Thank you.

Bharat Seth: Sir, just to get a feel particularly on manufacturing side, our substantial improvement I believe has come because of our raw material as a percentage to sales. So really, can you throw because even for full year last year it was 61.53%, now it has gone down to 53.62%, so where do you see such stabilisation?

And second thing, can you give us what rate we are operating both division, linen division as well as this drapery division?

K.P. Pradeep: Bharat, on the first question, on the material side, yes, the raw material has been a lot more stable than we have seen in the past quarters. We have also seen enhanced realisations. So raw material as a percentage of sales has worked to our benefit.

We anticipate some volatility in the next few quarters on the cotton yarn. Given that the raw material is a little sensitive in the Indian context and market movements are pretty sharp we have taken some steps from our end to mitigate. We have covered a proportion of our requirements into the future. We have also effectively changed the sourcing pattern to reflect greater flexibility.

I am sorry, your next question was relating to?

Bharat Seth: What level we are operating **--** the two manufacturing divisions?

K.P. Pradeep: Our bed linen manufacturing plant is at Hassan, Karnataka and our Drapery and upholstery division is at Doddaballapur near Bangalore. The bed linen side of the facility is operating at around 81%, and the silk facility is operating in the 49-50% capacity utilisation level.

Bharat Seth: So I believe this is the drapery division which is where we have got our very high contribution margins. So how do we really plan to improve its operating efficiency? I mean, 49-50%, so where do you see going ahead operating level?

K.P. Pradeep: Bharat, in the past too – this plant has worked to a maximum of 70 to 75 %. Traditionally in the luxury end of this segment, the capacity utilisation is always in this region. However, I do agree with you that the utilisation is a little low, given the history of this plant. However, there are marketing and sales initiatives and cost optimisation initiatives that are currently on at the curtain upholstery side of the business. That should help us in the future to come back to a reasonable capacity utilisation as well as regain margins.

Bharat Seth: Can you share the volume of both the divisions?

K.P. Pradeep: Volume in terms of?

Bharat Seth: How much – normally for drapery we give – how much – what is the volume vis-à-vis last quarter?

K.P. Pradeep: For example, you are talking about quarter or annualised?

Bharat Seth: Quarter.

K.P. Pradeep: For the quarter it should be doing in the region of around 230,000-235,000 metres and comparable should be around the same for the past .

Bharat Seth: Okay. So now this quarter also, what was our target, what level we plan to…

K.P. Pradeep: In the current year?

Bharat Seth: Yes.

K.P. Pradeep: In the current year we are targeting a capacity utilisation at the Drapery and Upholstery plant in the region of roughly 55-56%.

Bharat Seth: Okay, that will give you somewhere around 9-10 lakh metre?

K.P. Pradeep: Yes

Bharat Seth: Sir, just on cotton price, what price currently is prevailing, what was the effective cost in Q1, and you said we have coverage, so for how many months should we have coverage and what rate?

K.P. Pradeep: It is a difficult answer to provide, Bharat, because we do different yarn counts. We source both imported yarn, and local yarn and the general indicators in India may not reflect the type of yarns that we source.

We are covered on some of our major yarn counts for four to five months into the future. That should take us into the Q4 of FY13. So to that extent we have been able to anticipate and manage some of our requirements.

Bharat Seth: So I mean looking at this current monsoon in the quarter, I mean drought kind of a situation, particularly on crop side, so where again we had seen we had a very big hit in '10-'11 on manufacturing side because of high cotton price. So again, do you see that maybe repeated after one or two quarters?

K.P. Pradeep: From a Himatsingka perspective we source raw materials from both the local and overseas markets. Of late we see the imported yarns dominate the share of the total sourcing basket. Secondly, we do see positive arbitrage at which we source yarn in the overseas markets as compared to local markets. Thirdly, there is no problem with availability of raw-materials on imports. Given this I don't anticipate any major issues as we have seen in the past. We will of course have to watch the situation very carefully given our experiences in the past.

Bharat Seth: Okay. I mean on imported side also, what is the price trend, could you give some guidance, what is the price trend over the last two-three months and what is the current rate prevailing?

K.P. Pradeep: Generally you tend to see a 3-4% differential between a local and imported sourcing.

Bharat Seth: So second thing, our employee cost has also gone up in this quarter y-o-y as well as other expenses shoot up substantially. So is there any specific reason?

K.P. Pradeep: We have had some additional workforce at the bed linen plant. Apart from that, if you look at the other expenses, the major component is the fuel cost. As you are aware we have merchant sale of power from our captive power plant. We had unseasonal sale of power in this quarter as compared to the same position last year and hence the additional cost of fuel for generating such power has been reflected in these costs.

Bharat Seth: But it is almost at 50%, so 23 crores has become 32 crores.

K.P. Pradeep: Yes, we have increased the merchant power sale in this quarter as a result of which the fuel costs are higher by 4.63 crores. Other costs include overhaul expenses and stores and spares of machinery amounting to Rs. 1.88 crores among other costs.

Bharat Seth: So can you quantify that?

K.P. Pradeep: If you want I can send you a separate list of those expenses, Bharat.

Bharat Seth: I will appreciate this.

K.P. Pradeep: Let me have your coordinates and we will send it across to you.

Bharat Seth: Yes, I think Ashutosh is having my email ID. And second, recently we have taken an enabling resolution for fund raising, what are your plans that – yes, we plan to raise 150 crores, so I mean what is the purpose of taking this and when do we plan...

K.P. Pradeep: Bharat, if you recall, one of the main reasons for the QIP, at least a year and a half ago was the fact that we needed to enhance our retail presence within this geography for the atmosphere brand.

We have 12 stores in India, one store in Dubai, one store in Singapore. We were planning to enhance that presence to around 40 stores. And we were also planning a mid-market brands with a 130-store roll out. We still believe that we should look at this market in a very significant way. We do not know the exact timing of the launch. We anticipate over the next couple of quarters to be able to fructify some of these plans . In the context we are going back to our shareholders with an enabling resolution.

Bharat Seth: Are we planning a QIP or we are planning right issue or something?

K.P. Pradeep: The resolution is for QIP.

Bharat Seth: Okay. Thanks a lot. That is all from my side.

Moderator: Thank you so much, Mr. Seth. I would repeat once again to all the attendees and the participants, if you wish to ask any questions, please press "0" and "1" on your telephone keypad and wait for your name to be announced. I would 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. And the next question comes from Mr. Rajesh Pherwani from HDFC Mutual Funds [ph]. Mr. Serwani, your line has been un-muted.

Rajesh Perwani: Thanks. Just on the seasonality factor in the business. If you see the second and third quarter are the better quarters for the company, given that, how do you see the current outlook in terms of top line? Anything you can give us more on the guidance for the company?

K.P. Pradeep: Rajesh, the trend will continue. From a top line perspective, we anticipate Rs. 1525 to Rs. 1550 crores. We do not make any specific bottom line guidance. We expect a stable year ahead.

Rajesh Perwani: And what sort of margins, do we expect to maintain margins where they are correctly, anything sequential?

K.P. Pradeep: Expect to maintain margins.

Rajesh Perwani: And how are you seeing on the raw material front, silk, how do you see the cost moving on the raw material front, silk and cotton? I mean, cotton we have seen, they being stable, but what about silk?

K.P. Pradeep: Rajesh, as you are aware, silk was traditionally at a price range of $23-$24 per kg of silk and went up to $62-$63 some time ago and is currently at around $45-$46. We believe it could be lower. Also the product mix has undergone various changes . We do a lot of blends apart from silk. We do blends in poly, we do blends in cotton. So given the blend in product mix, innovative product designs we should be able to mitigate the impact of these prices. The market in the Drapery and Upholstery segment is recovering, but very slowly.

Rajesh Perwani: What is the average cost of silk last year and current year, what is the comparison?

K.P. Pradeep: The average cost would be in the region of around $49-$50 last year, vis-a-vis, we are averaging around 45-46 this year.

Rajesh Perwani: And this growth in top line, how much do you see coming due to volumes, and how much due to price?

K.P. Pradeep: A combination of both price and volume but trended more on the side of price.

Rajesh Perwani: What about tax rates in the current year?

K.P. Pradeep: Between 18-20%.

Rajesh Perwani: And CapEx is about 10-15 crores, right?

K.P. Pradeep: 10-15 crores.

Rajesh Perwani: Which is excluding retail...

K.P. Pradeep: As and when we go for the retail expansion, we get that funded separately.

Rajesh Perwani: How much are you planning to spend there?

K.P. Pradeep: That will depend on the actual roll out. The QIP estimate is for 150 crores. The actual spend will depend on the type of roll out.

Rajesh Perwani: Thank you.

Moderator: Thank you, Mr. Rajesh. I would 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. There are no more questions in the queue, I would request Mr. Amit Mishra to please take over the floor for the final comments.

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

K. P. Pradeep: I thank all the participants on the call. We look forward to seeing you on the next quarters earnings call. 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 all the panellists, and all the speakers. With this, we conclude the conference for today. Wish you all a great day ahead. You all can disconnect you line. Thank you so much.