

HIMATSINGKA SEIDE

INR 134

*Results in-line, Bellora acquisition announced*

BUY

Himatsingka Seide (HSL)'s Q3FY07 results were in line with expectations. Net revenues grew 13.5% Y-o-Y to INR 463 mn. Higher raw material (yarn) cost and expenses related to the on-going expansion led to EBITDA margin decrease by 170 bps Y-o-Y to 30.6%. Higher Other Income led to PAT growth of 26% Y-o-Y at INR 151 mn. HSL has also announced acquisition of 70% equity stake in premium bed-linen brand and boutique- Bellora- in Italy. Its retail venture "Atmosphere" clocked 273 % Y-o-Y growth in profits at INR 8.2 mn.

We maintain 'BUY' on HSL on likely benefits from bed-linen project and forward integration into retail and brands resulting in EPS CAGR of ~38% over FY06-09E. At CMP of 134, it is trading at a PE of 15.7x and 10.3x our FY08E and FY09E estimates respectively.

Key highlights for the quarter

- ◆ **Revenues for the quarter grew 13.5% Y-o-Y to INR 463 mn**
 - Driven by a 22% increase in fabrics revenue to INR 395 mn, realizations improved 7% Y-o-Y to INR 952 /mt, while volume grew 14%.
 - Yarn revenue decreased 18% to INR 68.1 mn on the back of volume de- growth of 27% and realization growth of 11% Y-o-Y.
- ◆ **EBITDA up 7.4% Y-o-Y to INR 142 mn; EBITDA margin down by 170 bps**

This was largely on account of expenses related to the on-going expansion (including staff expenses of INR 5 mn due to expansion in corporate staff and marketing expenses of INR 9 mn). Higher raw material (yarn) prices too contributed to the 170 bps Y-o-Y decrease in EBITDA margin to 30.6%.
- ◆ **Net income rose 26% Y-o-Y to INR 151 mn**

Net income rose on account of a 176% rise in other income. This was mostly on account of the unutilized GDR proceeds of USD 60 mn, which is being kept for international acquisitions which HSL is in the process of undertaking.
- ◆ **Bellora acquisition announced, bed-linen operations to commence from April**

HSL has also announced acquisition of 70% equity stake in premium bed-linen brand and boutique- Bellora- in Italy. This will act as the front end for its soon to be commissioned bed-linen manufacturing project in Hassan. Management has indicated that Bellora will take ~12 months to get fully scaled –up and give steady returns. HSL had earlier indicated that the acquisitions (1 or 2 more are in the pipeline) are likely to be at 0.5-0.7x revenue multiple and @ 17-18% returns. Bed-linen manufacturing operations in Hassan SEZ will start from April' 2007.

Financials

Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY07E	FY08E
Net revenues (INR mn)	463	408	13.5	470	(1.5)	1,784	3,947
EBITDA (INR mn)	142	132	7.4	159	(10.9)	609	1,515
Net profit (INR mn)	151	120	26.1	162	(7.1)	592	836
EPS (INR)	1.7	3.1	(46.7)	1.5	12.6	6.1	8.6
P/E (x)						22.1	15.7
EV/EBITDA (x)						22.1	14.2
ROE (%)						10.0	13.2

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Reuters : HMSD.BO
Bloomberg : HSS IN

Market Data

52-week range (INR) : 172 / 82
Share in issue (mn) : 97.4
M cap (INR bn/USD mn) : 13.6 / 308.1
Avg. Daily Vol. BSE/NSE ('000) : 87.1

Share Holding Pattern (%)

Promoters : 50.4
MFs, Fls & Banks : 12.4
Fls : 13.9
Others : 23.2

◆ **Domestic retail venture *Atmosphere* shows strong growth**

- At INR 127 mn and INR 13mn, HSL's retail business (HWPL) reported a strong growth of 52% and 273% in net revenues and PAT, respectively, Y-o-Y.
- HSL is expected to consolidate these numbers from Q1FY08.

◆ **Valuations- upsides from acquisition, expansion and retail**

We have modified our FY07E and FY08E forecasts slightly to factor in lower depreciation and interest costs in FY07 (due to delay in the bed-linen project) as well as lower EBITDA margin in bed-linen in FY08 due to delay in capacity ramp-up.

HSL continues to trade at a premium to most other Indian textile manufacturing companies due to its premium positioning and strong & steady performance. Although we do not expect any PE re-rating from the current ~16x 1 year forward level, we believe the on-going expansion in bed-linen, retail acquisitions in Europe and *Atmosphere* will keep earnings growing at the steady pace, with a likely spike in FY09E. RoCE will also increase in FY09 when the acquisitions/ expansions stabilize to ~15.5% from the current ~10% level. We expect EPS CAGR of ~38% over FY06-09E and the stock price to continue to factor this in over the next 12 months. At CMP of 134, it is trading at a PE of 15.7x and 10.3x our revised FY08E and FY09E estimates respectively. We maintain our "Buy" recommendation.

* **Addendum- About Bellora acquisition**

Himatsingka Seide Ltd has announced that the Company has entered into definitive agreements to acquire a 70% equity stake in Giuseppe Bellora SpA, Italy. The transaction is expected to be completed in February 2007.

Established in 1883, the Bellora brand is a pan European luxury brand in the Bed Linen segment. Apart from exclusive stores in Italy and other parts of Europe such as Spain, Portugal, Switzerland, Germany and France, the brand has a presence in up market departmental stores, the likes of Harrods, London, La Rinascente, Milan, Bonne Marche, Paris among several others. During 2006, Bellora generated revenues of about Euros 29 Million. It has 17 own stores- most of them in Italy – and also in Spain and Portugal. 60% of sales took place through their own stores in FY06, the rest was through high-end multi-brand retail stores (e.g. Harrods) and franchisee stores. 90% of its sales is in bed-linen (mostly cotton and linen) and the rest in bath products including robes and bathing liquids.

The current owners have an option to sell out the remaining 30% in two tranches of 15% each at the end of the second year and the fifth year from the close of the acquisition. We will get more details on this post the deal closure on the 19th of February.

(INR mn)

Financial snapshot								
Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY06	FY07E	FY08E
Revenues	463	408	13.5	470	(1.5)	1,509	1,784	3,947
Dec/(inc) in stock	(76)	(6)	1,254.0	11	(817.9)	(44)	-	-
Raw material	242	147	64.0	152	59.4	559	609	1,515
Staff costs	63	42	49.0	58	9.0	183	223	549
Manufacturing expenses	38	41	(7.5)	40	(5.6)	124	160	309
Admin, sales & sther expenses	54	51	6.2	51	6.4	170	214	507
Total expenditure	321	276	16.4	311	3.3	991	1,205	2,879
EBITDA	142	132	7.4	159	(10.9)	518	579	1,067
Interest	1	1	3.6	1	4.8	11	5	37
Depreciation	37	35	6.8	37	(0.3)	138	161	355
Other income	68	25	175.8	69	(0.6)	143	255	267
PBT	172	121	42.2	189	(9.4)	512	667	942
Tax	21	1	1,790.9	27	(23.0)	29	75	106
Net profit	151	120	26.1	162	(7.1)	483	592	836
Adjusted net profit	151	120	26.1	162	(7.1)	483	592	836
Equity capital (FV INR 5)	487.2	191.2		487.2		487	487	487
No. of shares (mn)	97.4	38.2		97.4		97.4	97.4	97.4
EPS (INR)	1.55	3.13		1.67		4.96	6.08	8.58
PE (x)						27.1	22.1	15.7
EV/EBITDA (x)						20.5	22.1	14.2
as % of net revenues								
Raw material	35.9	34.8		34.5		34.1	34.1	38.4
Staff expenses	13.6	10.4		12.3		12.1	12.5	13.9
Manufacturing expenses	8.2	10.0		8.5		8.2	9.0	7.8
Admin, sales & other expenses	11.7	12.5		10.8		11.3	12.0	12.8
EBITDA	30.6	32.3		33.8		34.3	32.4	27.0
Interest	0.3	0.3		0.2		0.8	0.3	0.9
Depreciation	8.0	8.6		7.9		9.1	9.0	9.0
Other income	14.8	6.1		14.6		9.5	14.3	6.8
Net profit	32.6	29.3		34.5		32.0	33.2	21.2

Company description

Himatsingka Seide is India's premium silk furnishings manufacturer/ exporter. The company has historically delivered excellent margins (historical EBITDA margin of up to 40%). HSL is a niche player with strong designing skills for manufacturing of premium silk fabrics for made-ups as well as dresses. It also has a strong global customer base with clients like the Robert Allen Group (USA), the Kravet Group (USA), the Colefax Group (UK), Polo Ralph Lauren (USA), Jab Josef Anstoetz (Germany), Rubelli (Italy) and Nobilis (France). Its exports account for more than 85-90% of its revenues.

While the silk furnishings business is expected to grow at a steady 8-10 % going forward, HSL is currently focusing on three major initiatives:

- An INR 400 mn bed-linen manufacturing project at the Hassan SEZ will should commence production by the middle of this year. The capacity will come in two phases of 10 mn metres each, likely to commence operations from April' 2007 and September' 2007 respectively.
- Acquisition of brand and retail companies in Europe in the home textiles (bed-linen) space, which will act as the selling channel for a significant part of its bed-linen production.
- It has also entered into a luxury home furnishings retail initiative through its Atmosphere stores which is in its wholly owned subsidiary- Himatsingka wovens private ltd. It will soon have 15 stores in India and one in Dubai.

Investment thesis

HSL historically has had very high margins as well as RoCEs (~18%) because of its presence in the premium segment of the company. It did a GDR of USD 60 mn in FY06 for acquisitions in Europe and took TUF sanctions for its bed-linen manufacturing project. Since then, it has been sitting on a lot of cash (INR 3500 mn as of now). This cash when deployed, through the bed-linen project and the European acquisitions, is expected to push its RoCE back close to the historical levels. Its European acquisition of premium brand & retail chain would allow him to capture the entire profit pool from manufacturing to retail of premium bed-linen at high-end European prices and lower Indian manufacturing costs. Although we do not expect any PE re-rating from the current ~16x 1 year forward level, we believe the on-going expansion in bed-linen, retail acquisitions in Europe and *Atmosphere* will keep earnings growing at the steady pace, with a likely spike in FY09E. We expect EPS CAGR of ~38% over FY06-09E and the stock price to track this growth.

Risks to the recommendation

- Any decrease in its contribution margin in the core silk furnishing business either due to pricing pressure or raw material (yarn) price increases.
- Lower than expected returns from the expansion and acquisitions. We have assumed the acquisition to give ~11-12% RoIC over FY08-09E. We have factored 22% and 27% EBITDA margins for the bed-linen manufacturing project in FY08 and FY09 respectively.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	1,380	1,509	1,784	3,947	5,539
Manufacturing expenses	523	638	769	1,824	2,665
Employee expenses	159	183	223	549	736
S G & A expenditure	139	170	214	507	569
EBITDA	559	518	579	1,067	1,569
Depreciation	125	138	161	355	400
EBIT	434	380	418	712	1,169
Interest expenditure	12	11	5	37	70
Other income	65	143	255	267	342
Profit before tax	488	512	667	942	1,441
Provision for taxation	32	29	75	106	162
Profit after tax	456	483	592	836	1,279
Recurring net profit	456	483	592	836	1,279
Extraordinary items/ Prior period items	(8)	-	-	-	-
Reported profit	448	483	592	836	1,279
EPS (INR) fully diluted	4.8	5.0	6.1	8.6	13.1
CEPS (INR) fully diluted	6.0	6.4	7.7	12.2	17.2
Dividend per share	2.0	2.5	2.4	3.4	5.3
Dividend payout ratio (%)	32.5	39.3	31.5	28.1	30.5

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	37.9	42.3	43.1	46.2	48.1
Employee expenses	11.6	12.1	12.5	13.9	13.3
S G & A expenses	10.0	11.3	12.0	12.8	10.3
Depreciation	9.0	9.1	9.0	9.0	7.2
Interest expenditure	0.9	0.8	0.3	0.9	1.3
EBITDA margin	40.5	34.3	32.4	27.0	28.3
EBIT margin	31.5	25.2	23.4	18.0	21.1
Net profit margin	33.0	32.0	33.2	21.2	23.1

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	1.8	9.4	18.2	121.2	40.4
EBITDA	(0.2)	(7.4)	11.8	84.4	47.1
EBIT	5.2	(12.5)	10.0	70.3	64.3
Net profit	(11.4)	7.9	22.6	41.2	52.9
EPS	(8.2)	4.1	22.6	41.2	52.9

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	191	487	487	487	487
Reserves	2,680	5,249	5,604	6,106	6,874
Shareholders funds	2,872	5,736	6,092	6,593	7,361
Secured loans	585	398	1,898	3,000	2,625
Deferred tax liability	18	27	27	27	27
Sources of funds	3,475	6,160	8,016	9,620	10,012
Gross assets	1,999	2,152	4,152	6,152	6,352
Less: Depreciation	1,078	1,212	1,373	1,728	2,128
Net fixed assets	921	940	2,779	4,424	4,224
Capital WIP	164	200	800	-	-
Investments	1,643	1,266	1,266	2,416	2,416
Current assets	1,092	4,187	3,592	3,315	3,992
Debtors	232	306	293	649	911
Cash and bank balance	147	2,922	2,224	1,009	981
Inventory	294	425	440	973	1,366
Advances	420	534	634	684	734
Current liabilities	345	442	430	544	628
Creditors	52	93	81	195	280
Other liabilities	10	12	12	12	12
Provisions	283	337	337	337	337
Working capital	747	3,745	3,161	2,771	3,363
Misc expenditure	-	9	9	9	9
Uses of funds	3,475	6,160	8,016	9,620	10,012
BV (INR)	29	59	63	68	76

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	371.1	333.6	516.1	857.2	1167.5
Cash for working capital	103.3	222.8	114.1	825.2	620.0
Net operating cash flow (A)	474	556	630	1,682	1,787
Net purchase of fixed assets	(124.8)	(193.0)	(2599.6)	(1200.0)	(200.0)
Net purchase of investments	(460.0)	376.6	0.0	(1150.0)	0.0
Net cash flow from investing (B)	(585)	184	(2,600)	(2,350)	(200)
Proceeds from LTB/STB	447.3	(187.5)	1500.0	1102.5	(375.0)
Proceeds from equity /Dividend payments	0.0	2709.2	(2640.4)	0.0	0.0
Net cash flow from financing	447	2,522	(1,140)	1,103	(375)
Free cash flow	349	363	(1,969)	482	1,587

Ratios					
Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE	16.2	11.2	10.0	13.2	18.3
ROCE	14.4	10.9	9.5	11.1	15.4
Debtors days	61.3	74.1	60.0	60.0	60.0
Inventory days	77.8	102.8	90.0	90.0	90.0
Fixed assets t/o	1.3	1.4	0.8	1.0	1.3
Debt/equity	0.2	0.1	0.3	0.5	0.4
Interest coverage	41.8	45.5	122.9	26.6	21.5

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	4.8	5.0	6.1	8.6	13.1
<i>Y-o-Y growth (%)</i>	<i>(8.2)</i>	<i>4.1</i>	<i>22.6</i>	<i>41.2</i>	<i>52.9</i>
CEPS	6.0	6.4	7.7	12.2	17.2
PE (x)	28.3	27.1	22.1	15.7	10.3
FCFPS (INR)	3.6	3.7	(20.2)	5.0	16.3
<i>Y-o-Y growth (%)</i>	<i>(48.2)</i>	<i>4.0</i>	<i>(641.9)</i>	<i>(124.5)</i>	<i>229.1</i>
Price/BV	4.6	2.3	2.2	2.0	1.8
EV/sales	1.4	7.0	7.2	3.8	2.7
EV/EBITDA	3.5	20.5	22.1	14.2	9.4
Dividend yield (%)	1.5	1.9	1.8	2.6	3.9

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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