

Good results but valuations remain a concern



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Stronger topline leads to results 10% ahead of expectations

2Q profits at Rs162mn (23% YoY growth) were about 10% ahead of MLe. 1HFY07 profits were up 25% YoY. 2Q growth was driven by a strong 24% YoY growth in topline, significantly higher than estimates. However, EBIDTA margins declined by 450 bps in line with expectations on higher raw material (silk) costs. We maintain a Neutral rating on the stock due to rich valuations.

Strong sales growth but lower EBIDTA margin

Strong sales growth of 24% YoY was driven by 1) 13% YoY rise in fabric realizations primarily on the back of cost push from high silk prices, and 2) near doubling of silk yarn sales, which was a surprise. EBIDTA margins, however, declined by 450bp to 33.8%, mainly due to continued high silk prices.

FY07 estimates tweaked, maintain FY08E

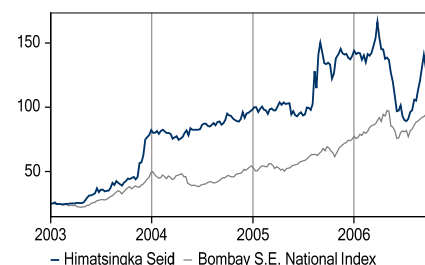
While we have maintained our sales and EBIDTA forecasts, we have raised the profit estimates for FY07E by about 10% (implying a 16% YoY growth), primarily to factor in higher other income and lower depreciation due to a likely slight delay in commissioning of the new bed linen plant. Our FY08E forecasts remain unchanged.

Slower 2H growth, changing business model - Neutral

We expect profit growth to be lower at about 7% YoY in 2H as against 25% YoY growth registered in 1H. At 15.4x FY08E earnings, the stock is trading at about 20% premium to other Indian textile companies in our coverage universe. We believe that this discount would narrow down as the company enters into the less profitable bed linen business. We maintain a Neutral recommendation.

Stock Data

Price	Rs131.00
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs82.15-Rs171.90
Mkt Val / Shares Out (mn)	US\$282 / 97.4
Average Daily Volume	17,615
ML Symbol / Exchange	HMKAF / BSE
Bloomberg / Reuters	HSS IN / HMSD.BO
ROE (2007E)	9.7%
Net Dbt to Eqty (Dec-1899A)	-44.6%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	51.5%



Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	455	486	564	830	1,119
EPS	5.84	4.99	5.79	8.52	11.48
EPS Change (YoY)	-5.1%	-14.5%	16.0%	47.2%	34.8%
Dividend / Share	2.50	2.50	2.50	2.50	2.50
Free Cash Flow / Share	5.12	2.38	(15.95)	(12.30)	7.26

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	22.44x	26.25x	22.63x	15.37x	11.41x
Dividend Yield	1.91%	1.91%	1.91%	1.91%	1.91%
EV / EBITDA*	19.37x	20.62x	18.47x	9.45x	6.97x
Free Cash Flow Yield*	3.07%	1.53%	-12.17%	-9.39%	5.54%

* For full definitions of *iQmethod*SM measures, see page 6.

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*iQprofile*SM Himatsingka Seide Ltd.

Key Income Statement Data (Mar)	2005A	2006A	2007E	2008E	2009E
(Rs Millions)					
Sales	1,498	1,623	1,880	4,428	5,887
Gross Profit	765	746	848	1,665	2,144
Sell General & Admin Expense	(201)	(216)	(256)	(507)	(573)
Operating Profit	430	380	429	803	1,205
Net Interest & Other Income	49	137	205	90	25
Associates	NA	NA	NA	NA	NA
Pretax Income	479	517	634	893	1,230
Tax (expense) / Benefit	(32)	(31)	(70)	(62)	(111)
Net Income (Adjusted)	455	486	564	830	1,119
Average Fully Diluted Shares Outstanding	76	97	97	97	97

Key Cash Flow Statement Data

Net Income (Reported)	446	486	564	830	1,119
Depreciation & Amortization	134	150	163	355	365
Change in Working Capital	(64)	(236)	(124)	(1,100)	(556)
Deferred Taxation Charge	4	8	18	16	29
Other Adjustments, Net	8	0	0	0	0
Cash Flow from Operations	529	409	621	102	957
Capital Expenditure	(137)	(213)	(2,175)	(1,300)	(250)
(Acquisition) / Disposal of Investments	(391)	399	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(528)	186	(2,175)	(1,300)	(250)
Shares Issue / (Repurchase)	0	2,917	0	0	0
Cost of Dividends Paid	(191)	(278)	(278)	(278)	(278)
Cash Flow from Financing	256	2,451	325	772	(278)
Free Cash Flow	391	195	(1,554)	(1,198)	707
Net Debt	424	(2,539)	(712)	760	330
Change in Net Debt	405	(2,963)	1,826	1,472	(429)

Key Balance Sheet Data

Property, Plant & Equipment	1,184	1,250	3,262	4,207	4,092
Other Non-Current Assets	0	0	0	0	0
Trade Receivables	214	308	361	849	1,129
Cash & Equivalents	161	2,936	1,712	1,290	1,720
Other Current Assets	2,232	2,048	2,263	3,849	4,648
Total Assets	3,791	6,542	7,598	10,195	11,588
Long-Term Debt	0	0	750	1,800	1,800
Other Non-Current Liabilities	18	26	44	61	90
Short-Term Debt	585	398	250	250	250
Other Current Liabilities	354	426	570	1,544	2,067
Total Liabilities	957	850	1,614	3,655	4,206
Total Equity	2,834	5,692	5,984	6,540	7,381
Total Equity & Liabilities	3,791	6,542	7,598	10,195	11,588

*iQmethod*SM - Bus Performance*

Return On Capital Employed	12.2%	7.9%	6.5%	9.6%	12.1%
Return On Equity	16.3%	11.4%	9.7%	13.3%	16.1%
Operating Margin	28.7%	23.4%	22.8%	18.1%	20.5%
EBITDA Margin	37.7%	32.7%	31.5%	26.2%	26.7%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	1.2x	0.8x	1.1x	0.1x	0.9x
Asset Replacement Ratio	1.0x	1.4x	13.3x	3.7x	0.7x
Tax Rate (Reported)	6.8%	5.9%	11.0%	7.0%	9.0%
Net Debt-to-Equity Ratio	15.0%	-44.6%	-11.9%	11.6%	4.5%
Interest Cover	36.0x	33.1x	30.1x	19.1x	21.4x

Key Metrics

* For full definitions of *iQmethod*SM measures, see page 6.

Company Description

Himatsingka Seide is India's leading silk/silk-blended fabric exporter. It also operates premium furnishing-fabric retail stores under the name Atmosphere. The company plans to expand into bed linen and other top-of-the-line bedding items. Its products are design intensive, which gives the company substantive pricing power and help it earn the highest operating margins in the industry at over 30%.

Stock Data

Price to Book Value 2.1x

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2QFY07 Results Analysis

Table 1: Himatsingka (Standalone) results

(Rs mn)	2QFY07	2QFY06	YoY chg	1HFY07	1HFY06	YoY chg Comments
Net sales	470	378	24.3%	848	720	17.8% Higher fabric realizations & yarn sales (Refer Table 2 below) beat our expectations
Raw material cost	162	113	43.5%	280	213	31.8% Higher silk prices
% of sales	34.5%	29.9%		33.1%	29.5%	
Staff cost	58	42	36.1%	103	83	23.9%
% of sales	12.3%	11.2%		12.2%	11.6%	
Other expenditure	91	78	17.1%	179	146	23.0%
% of sales	19.4%	20.6%		21.2%	20.3%	
Total expenditure	311	233	33.4%	563	442	27.4%
EBIDTA	159	145	9.7%	285	278	2.5% 450 bp decline in EBIDTA margin in-line with expectations mainly due to higher silk prices
EBIDTA margin	33.8%	38.3%		33.6%	38.6%	
Depreciation	37	36	4.3%	73	71	2.6%
Interest	1	4	-73.1%	2	9	-76.2%
Other income	69	31	123.9%	130	63	107.6% Higher other income due to unutilized GDR proceeds
PBT	189	136	39.5%	340	261	30.6%
Tax	27	4	583.5%	34	15	120.1% Higher taxes due to higher component of other income which is fully taxable
% of PBT	14.3%	2.9%		10.0%	5.9%	
PAT	162	132	23.2%	306	245	24.9% 10% ahead of Mle

Source: Company, Merrill Lynch

Table 2: Sales break-up

	2QFY07	2QFY06	YoY chg	1HFY07	1HFY06	YoY chg Comments
Silk Fabric						
Sales value (Rs mn)	401	345	16.3%	731	633	15.4%
Volumes (mn meters)	0.42	0.41	3.0%	0.77	0.75	3.4% In-line volume growth
Realisations (Rs/meter)	959	849	12.9%	948	850	11.6% Continued high realizations better than expected
Silk Yarn						
Sales value (Rs mn)	69	36	94.4%	48	53	-9.7% High yarn sales in 2Q a surprise. Some Should be considered a one-off case as
Volumes (MT)	39	22	77.3%	26	32	-18.2% not a management focus area
Realisations (Rs/kg)	1,779	1,623	9.7%	1,808	1,638	10.4%

Source: Company, Merrill Lynch

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Table 3: Retail - Atmosphere (Himatsingka Wovens Ltd - 100% subsidiary) Results

(Rs mn)	Q2FY0	Q2FY0	YoY	1HFY0	1HFY0	YoY
	7	6	chg	7	6	chg
Net Sales	58	37	57.1%	110	71	53.4%
Expenses	51	33	56.1%	96	64	49.0%
EBITDA	6	4	65.8%	14	7	91.8%
Depreciation	3	3	-10.0%	6	6	-1.7%
Other						
Income	2	2	0.0%	3	3	3.3%
PBT	5	2	121.7%	11	4	156.8%
Taxation	0	0	0.0%	0	0	0.0%
PAT	5	2	127.3%	11	4	160.5%

All growth has come from the same 11 stores; particularly the ones in Mumbai and Bangalore have done very well. Dubai store slated to open in 4QFY07.

High operating leverage has resulted in strong PAT growth

Source: Company, Merrill Lynch

Analyst Certification

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Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Investment Rating Distribution: Textiles/Apparel Group (as of 30 Sep 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	8	38.10%	Buy	1	12.50%
Neutral	12	57.14%	Neutral	3	25.00%
Sell	1	4.76%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 30 Sep 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1325	44.76%	Buy	434	32.75%
Neutral	1420	47.97%	Neutral	412	29.01%
Sell	215	7.26%	Sell	48	22.33%

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