Sheela Foam Limited

Mattress Matters

Sheela Foam is a manufacturer of mattress brand 'Sleepwell' and has 11 manufacturing facilities in India (123,000 TPA capacity) and five manufacturing facilities in Australia (10,500 TPA). It has strong distribution network and derives 80% of domestic revenues from B2C channel.

Mattress Industry shifting from unorganised to organised players: The ₹9,000cr comfortable mattress industry is growing at 8-10% growth rate. As industry dynamics favor, organized player are growing faster (11-13%) than unorganized players (6-8) implying that organised players are gaining market share. The implementation of GST will further benefit the organised players in tax benefits and logistics costs and accelerate the shift from unorganized to organised players.

Lower penetration in the industry: The mattress industry has low penetration levels as 70% of population sleeps on traditional bedding and 30% sleeping on comfortable mattresses. With rising disposable income and increasing urbanization, penetration is likely to increase benefitting branded players.

Strong brand with significant market share: 'Sleepwell', its popular mattress brand, contributes 55% of its domestic revenue. Company is investing more in this brand for further growth through ad spends. In FY12, its ad spends were 2.7% of net sales which grew to 4.4% in FY16. This will benefit it going ahead. Company through its 'Sleepwell' brands holds ~20-23% market share.

Strong distribution network: Company has a pan-India distribution network consisting of 100 exclusive distributors, 2,000 exclusive retail dealers and 2,500 multi-brand outlets. Company sells its home comfort products through total ~1,600 exclusive 'Sleepwell' branded outlets as well as e-commerce portals. It is tapping all possible sales channels to increase its sales which is positive in our view.

Outlook and Valuation: On its FY17E's PAT of ₹121cr, the issue on its upper band is priced at P/E ratio of 27x which is at par with consumer durable peers which have strong brand and higher B2C sales. We consider following strong points as well 1) Net cash positive balance sheet 2) easing working capital cycle from >40 days in FY12 to current 26 days 3) improving return ratios with better product mix and 4) promoters experience. **Considering the market conditions we would not suggest this IPO for listing gains but rather we recommend 'Subscribe' on this issue for medium to long term perspective.**

Key Financials

Y/E March (₹ cr)	FY2014	FY2015	FY2016	1HFY17
Net Sales	1,271	1,418	1,550	796
% chg	*10.6*	*11.5*	*9.3*	-
Net Profit	28	43	105	66
% chg	*(9.8)*	*53.3*	*145.6*	-
OPM (%)	6.7	6.4	11.4	13.3
EPS (₹)	5.7	8.7	21.5	13.5
P/E (x)	127.9	83.5	34.0	-
P/BV (x)	18.1	14.5	10.5	-
RoE (%)	14.2	17.4	31.0	-
RoCE (%)	15.0	17.0	32.5	-
EV/Sales (x)	2.9	2.5	2.2	-
EV/EBITDA (x)	43.1	39.2	19.6	-

Source: Company, Angel Research

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Issue Open: November 29, 2016
Issue Close: December 01, 2016

Issue Details
Face Value: ₹5
Present Eq. Paid up Capital: ₹24.3cr (September 2016)
Offer for Sale: *75.0 lakh -**69.9 lakh Shares
Post Eq. Paid up Capital: ₹24.3cr
Issue size (amount): ₹510cr
Price Band: ₹680-730
Lot Size: 20 shares and in multiple thereafter
Post-issue implied mkt. cap: *₹3,317.2cr - **₹3,551.1cr
Promoters holding Pre-Issue: 100%
Promoters holding Post-Issue: 85.7%

**Calculated on lower price band*
*** Calculated on upper price band*

Book Building	
QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Pattern	
Promoters Group	85.7
DIIs/FIIs/Public & Others	14.3

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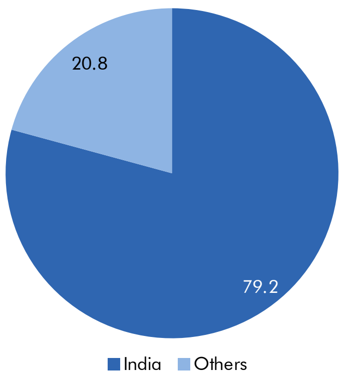
Company background

Sheela Foam, incorporated in 1971, is a manufacturer of popular mattress brand 'Sleepwell'. The company manufactures foam-based home comfort products such as mattresses, furniture-cushioning, pillows, cushions, etc. It also manufactures technical grades of polyurethane foam (PU foam) for end use in a wide range of industries such as automobile, garments, shoes, etc.

Company also has presence in Australia through its wholly owned subsidiary, Joyce Foam which also manufactures PU Foam which is used in comfort products, home furniture and end industries like auto components, sound absorption, etc.

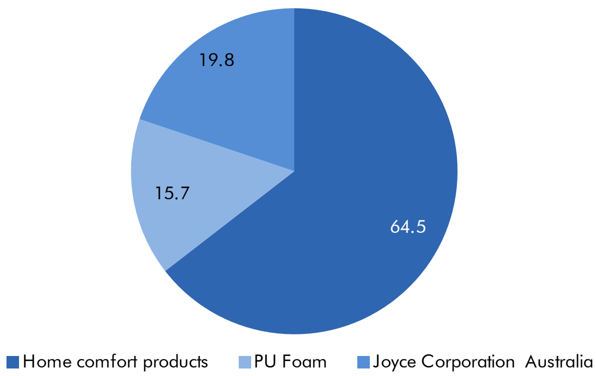
Company currently own and operate 11 manufacturing facilities in India, all of which are utilized for manufacturing home comfort products, while five of these facilities also manufacture PU Foam. Currently installed capacity for foam production in India is currently at 123,000 TPA. Joyce operates five manufacturing facilities in Australia that exclusively manufacture PU Foam, primarily through variable pressure foaming technology, and has a total installed production capacity of 10,500 TPA in Fiscal Year 2016.

Exhibit 1: Revenue mix (%)



Source: Company, Angel Research

Exhibit 2: Product mix (%)



Source: Company, Angel Research

Issue details

Through this IPO, existing shareholder (Polyflex Marketing Pvt Ltd) is selling some of its stake in the company worth ₹510cr. Polyflex Marketing is a corporate promoter of the company and currently holds 27.75% stake in Sheela Foam. Three of the Sheela Foam's directors who hold shares in Polyflex Marketing are selling their shares through the OFS.

Considering that the IPO is subscribed at the higher band, the total no of shares which will be sold works out to be 69.9 lakh, indicating 14.3% of its total outstanding shares.

Exhibit 3: Pre and Post-IPO shareholding pattern

Entity	Pre-Issue (%)	Post-Issue (%)
Promoters		
Ms. Sheela Gautam	36.0	36.0
Mr. Rahul Gautam	20.4	20.4
Polyflex Marketing Private Limited	27.8	13.4
Promoter Group	15.8	15.8
Promoter and promoter group	100.0	85.7
Public	0.0	14.3
Total	100.0	100.0

Source: RHP, Angel Research

Objects of the offer

- Achieve the benefits of listing of the equity shares on the stock exchanges

Investment Rationale

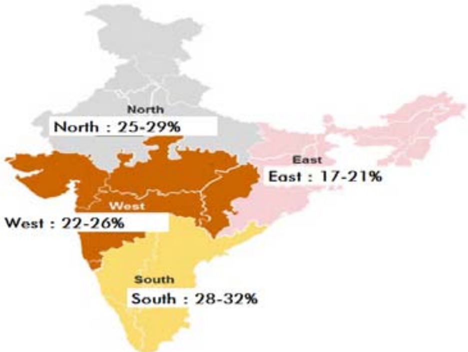
Operating in an underpenetrated industry: Sheela Foam is operating in mattress industry which is underpenetrated by branded players and dominated by local outfits specialising in hand-made mattresses. While traditional bedding represents a dominant part of this industry, a shift from cotton bedding to comfortable bedding has been a prevalent trend. These comfortable bedding market is pegged at ₹9,000cr and includes mattresses made of foam, coir and combinations thereof. The industry has secular growth drivers such as increasing unbanisation, growing income levels, shifting towards brands, etc.

Exhibit 4: Different types of mattresses

Source: Company, Angel Research

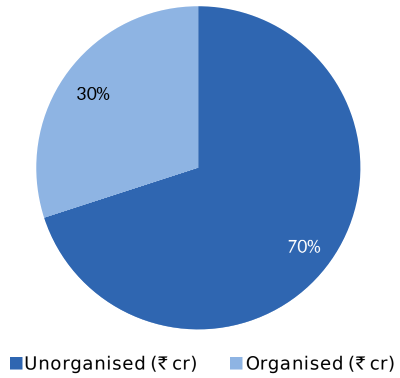
The unorganized players represent 70% of sales in the industry, which shows a strong potential for branded players. The industry is growing at 8-10% growth rate which we believe is an attractive growth rate. The organized players are gaining higher market share of this industry which can be seen from the growth numbers of organized market which is growing at growth rate of ~11-13% vs. unorganized market which is growing at rate of 6-8%. This is a very favorable dynamic for branded players like Sheela Foam which holds ~20-23% market share in this industry through its 'Sleepwell' brand.

Exhibit 5: Distribution of the domestic mattress market



Source: Company, Angel Research

Exhibit 6: Huge opportunity for branded players



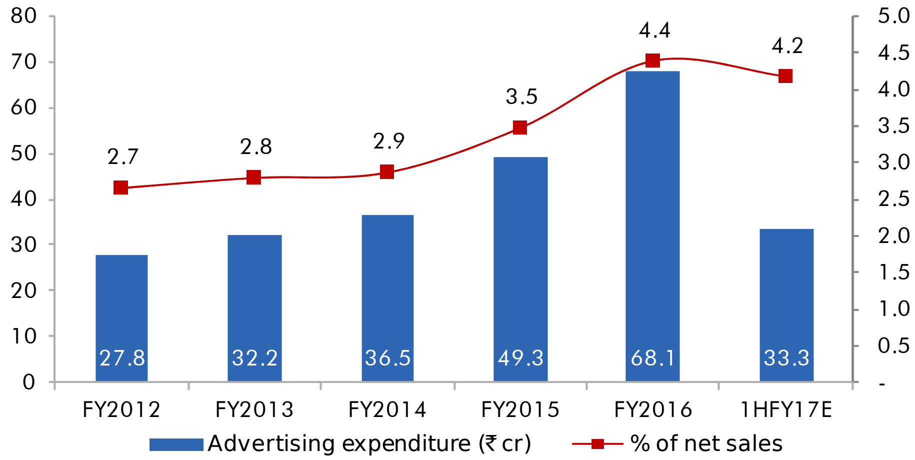
Source: Company, Angel Research

GST regime, a strong positive for branded players: The implementation of GST is likely to accelerate further shift of the industry from unorganized to organised. The GST regime is expected to benefit the industry through (1) bring tax savings in terms of phasing out of sales tax of 2% and (2) dropping logistics costs to the level of 1-1.5%. Due to the decline in the sales tax, the companies will be able to move closer to the demand areas which will help them to operate efficiently as well as reach out to the untapped areas and gain market share. So the GST will benefit companies by giving tax benefits, reducing logistics costs and helping them gain the market share.

Strong brand name and higher B2C sales: Sheela Foam generates 80% of its revenues from domestic operations and the rest 20% from its Australian operations. In India, company sells its products under its flagship brand 'Sleepwell'. It also has another brand named 'Feather Foam'. Sleepwell is its popular brand which contributes 55% of its domestic revenue. Total B2C contribution in the domestic business is 80% while that in the consolidated business is 65%.

Company ensures that its brands have high visibility through advertising and hence it is investing in its brands by increasing the advertising spends every year. In FY12, company spent 2.7% of net sales in advertising which grew to 4.4% of its net sales in FY16. This is likely to benefit the company going ahead.

Exhibit 7: Increasing ad spends to strengthen brand strength



Source: Company, Angel Research

Strong distribution network: Company has a pan-India distribution network consisting of 100 exclusive distributors, 2,000 exclusive retail dealers and 2,500 multi-brand outlets. On franchisee basis, company sells its home comfort products through total 1,602 exclusive 'Sleepwell' branded outlets. Company also has e-commerce presence as its products are also sold through e-commerce websites. This represents that the company is tapping all possible channels, in line with other players in consumer durables industry, to generate higher sales. We believe that the distribution network is robust in nature and in line with the competition.

Customized orders are helping the company to gain more market share: There are 18 different mattress sizes in India and vis-à-vis 4 standard sizes seen in the developed countries. While it is difficult cater to all sizes, company has used this as an opportunity to grab the market share by addressing this section of the industry as well. For this, company has a set a mechanism in which a representatives takes the measurements of the beds and recommends mattresses. Foam is then cut in its facilities and mattress is prepared according to the order and delivered to the customers place. This has also helped the company to grab higher market share as customers prefer road side vendors for these types of customized orders.

The company is also planning to set up two processing facilities (cutting, shaping of mattresses) near Jabalpur/Indore and Varansi. This will also help the company to further move close the demand centers and further increase its market share.

Exhibit 8: Manufacturing facilities near the major demand areas

Source: Company, Angel Research

Sheela Foam's other businesses: Sheela foam also has B2B presence in which it generates revenues by selling foam products to end industries in India and Australia. These products are manufactured in five of its Indian manufacturing facilities as well as all of its Australian units. These are technical grades of polyurethane foam (PU foam) to be used in the end industries. PU Foam has wide applications in range of industries such as automobile, furniture garments, shoes, sound industry, etc. This business represents 35% of its consolidated revenues and is growing at a CAGR of 7.5%. The wide array of industrial applications of the PU Foam, is a growth factor of this business and as end industries growth, this business will also show further growth.

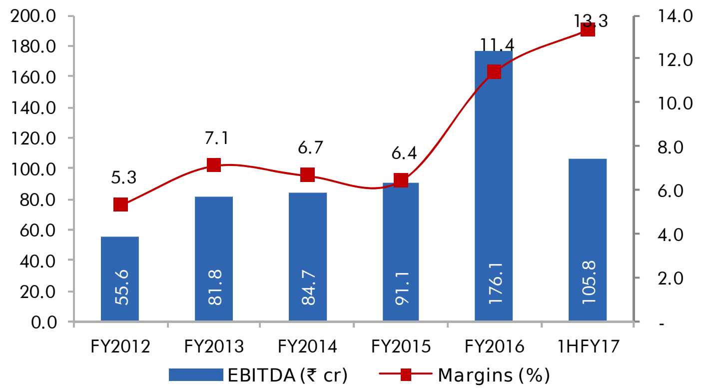
Recent financial performance: Company in FY2016 reported 11% yoy growth in its domestic home comfort revenues to ₹1,017cr. While domestic revenues from technical foam increased by 13% to ₹249cr. Revenues from Australian operations remained flat at ₹285cr. Owing to strong decline in the raw material prices and better product mix, company reported ~500bps expansion in its EBITDA margins to 11.4%. FY16 PAT came at ₹105cr, vs. ₹43cr in FY2015. With the strong growth, company also saw improvement in its RoE from 17.4% in FY2016 to 31.0% in FY2016.

In H1FY17, the strong performance has continued with company reporting total revenues of ₹796cr and PAT of ₹66cr. EBITDA margins were at 13.3%, showing further expansion due to the decline in raw material and product mix.

Company has a strong balance sheet with debt to equity ratio of less than 0.2x. It has consistently been able to reduce its debt from ₹244cr in FY12 to ₹86cr in FY16. The business has a decent working capital cycle which was at 44 days in

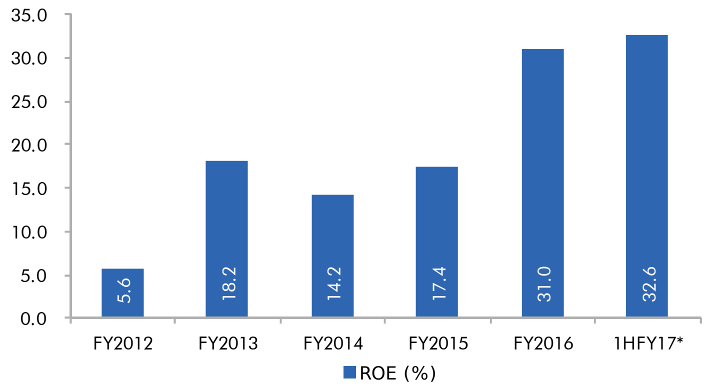
FY12 which eased to 26 days in FY16. The company has annual maintenance capex requirement of ₹30cr and has planned ₹80cr potential capex for aforesaid two processing plants.

Exhibit 9: Improving profitability



Source: Company, Angel Research

Exhibit 10: Improving RoE



*Source: Company, Angel Research *1HFY17RoE is annualised*

Outlook and Valuation: On its FY17E's PAT of ₹121cr, the issue on its upper band is priced at P/E ratio of 27x which is at par with consumer durable peers which have strong brand and higher B2C sales. We consider following strong points as well 1) Net cash positive balance sheet 2) easing working capital cycle from >40 days in FY12 to current 26 days 3) improving return ratios with better product mix and 4) promoters experience. **Considering the market conditions we would not suggest IPO for listing gains but rather we recommend 'Subscribe' on this issue for medium to long term perspective.**

Key risks

Raw material prices: Major raw materials of the company are TDI and Polypol. TDI price remain volatile like any other commodity and recently has seen very high volatility due to supply constraints. The sustained rise in TDI prices may impact the company financials going ahead as TDI makes 25% of its total raw material mix.

Higher competition: The industry in which company operates is dominated by unorganized players. While there are secular growth trends in the industry, higher competition may lead to lower pricing power for the company leading to decline in its profitability.

Income Statement

Y/E March (₹ cr)	FY12	FY13	FY14	FY15	FY16	1H1FY17
Total operating income	1,045	1,149	1,271	1,418	1,550	796
% chg		*10.0*	*10.6*	*11.5*	*9.3*	
Total Expenditure	989	1,067	1,186	1,327	1,374	690
Cost of Materials	649	694	775	871	828	402
Personnel	93	103	119	128	139	79
Others Expenses	248	270	292	327	407	209
EBITDA	56	82	85	91	176	106
% chg		*47.2*	*3.6*	*7.5*	*93.4*	*(39.9)*
(% of Net Sales)	*5.3*	*7.1*	*6.7*	*6.4*	*11.4*	*13.3*
Depreciation& Amortisation	25	31	30	28	29	14
EBIT	30	50	55	63	147	91
% chg		*65.7*	*8.8*	*15.3*	*132.7*	
(% of Net Sales)	*2.9*	*4.4*	*4.3*	*4.5*	*9.5*	*11.5*
Interest & other Charges	24	23	19	16	12	5
Other Income	6	12	1	11	17	8
(% of PBT)	*49.3*	*31.4*	*1.5*	*18.4*	*11.1*	*8.8*
Share in profit of Associates	-	-	-	-	-	-
Recurring PBT	12	40	36	58	152	94
% chg		*230.3*	*(8.8)*	*59.1*	*164.3*	
Prior Period & Extraord. Exp./(Inc.)	-	-	-	-	-	-
PBT (reported)	12	40	36	58	152	94
Tax	4	9	8	15	47	28
(% of PBT)	*34.8*	*22.2*	*23.0*	*25.8*	*31.1*	*30.0*
PAT (reported)	8	31	28	43	105	66
Add: Share of earnings of asso.	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-	-
PAT after MI (reported)	8	31	28	43	105	66
ADJ. PAT	7.8	30.9	27.8	42.7	104.8	66.0
% chg		*294.5*	*(9.8)*	*53.3*	*145.6*	
(% of Net Sales)	*0.7*	*2.7*	*2.2*	*3.0*	*6.8*	*8.3*
Basic EPS (₹)	1.6	6.3	5.7	8.7	21.5	13.5
Fully Diluted EPS (₹)	1.6	6.3	5.7	8.7	21.5	13.5
% chg		*294.9*	*(9.8)*	*53.3*	*145.6*	

Balance Sheet

Y/E March (₹ cr)	FY12	FY13	FY14	FY15	FY16	1H1FY17
SOURCES OF FUNDS						
Equity Share Capital	16	16	16	16	16	24
Reserves& Surplus	123	153	180	229	322	380
Shareholders' Funds	139	170	197	245	338	405
Minority Interest	-	-	-	-	-	-
Total Loans	244	207	170	127	113	86
Deferred Tax Liability	(2)	(0)	1	2	2	(1)
Total Liabilities	381	376	367	374	454	490
APPLICATION OF FUNDS						
Net Block	269	269	269	295	298	325
Capital Work-in-Progress	-	-	-	-	-	-
Investments	5	8	0	0	10	10
Current Assets	265	290	356	385	481	474
Inventories	92	116	124	118	105	132
Sundry Debtors	115	104	120	114	117	134
Cash	21	32	77	117	217	133
Loans & Advances	30	30	29	28	34	49
Other Assets	8	7	6	7	8	26
Current liabilities	159	191	258	306	334	319
Net Current Assets	106	99	98	79	146	155
Deferred Tax Asset	-	-	-	-	-	-
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	381	376	367	374	454	490

Cash Flow Statement

Y/E March (₹ cr)	FY12	FY13	FY14	FY15	FY16	1H1FY17
Profit before tax	12	40	36	58	152	94
Depreciation	25	31	30	28	29	14
Change in Working Capital	20	13	34	53	39	(68)
Interest / Dividend (Net)	24	23	19	16	12	5
Direct taxes paid	(20)	(6)	0	(2)	(47)	(39)
Others	(1)	(4)	5	(5)	(9)	(4)
Cash Flow from Operations	60	97	124	147	176	3
(Inc.)/ Dec. in Fixed Assets	(64)	(32)	(31)	(58)	(37)	(51)
(Inc.)/ Dec. in Investments	60	2	4	10	4	(2)
Cash Flow from Investing	(4)	(30)	(27)	(49)	(34)	(53)
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	15	(34)	(27)	(42)	(31)	(29)
Finance costs	(23)	(23)	(19)	(16)	(12)	(5)
Others	(56)	1	(7)	-	-	-
Cash Flow from Financing	(64)	(56)	(53)	(59)	(43)	(34)
Inc./(Dec.) in Cash	(8)	12	45	40	100	(84)
Opening Cash balances	28	21	32	77	117	217
Closing Cash balances	21	32	77	117	217	133

Key Ratios

Y/E March	FY12	FY13	FY14	FY15	FY16	1H1FY17
Valuation Ratio (x)						
P/E (on FDEPS)	455.9	115.4	127.9	83.5	34.0	-
P/CEPS	107.8	57.2	61.6	50.4	26.6	-
P/BV	25.6	21.0	18.1	14.5	10.5	-
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	-
EV/Sales	3.6	3.2	2.9	2.5	2.2	-
EV/EBITDA	68.0	45.6	43.1	39.2	19.6	-
EV / Total Assets	7.00	6.58	5.84	5.25	4.37	-
Per Share Data (₹)						
EPS (Basic)	1.6	6.3	5.7	8.7	21.5	-
EPS (fully diluted)	1.6	6.3	5.7	8.7	21.5	-
Cash EPS	6.8	12.8	11.9	14.5	27.5	-
DPS	0.0	0.0	0.0	0.0	0.0	-
Book Value	28.5	34.7	40.3	50.2	69.4	-
Returns (%)						
ROCE	7.9	13.4	15.0	17.0	32.5	-
Angel ROIC (Pre-tax)	8.5	15.0	18.9	24.8	65.4	-
ROE	5.6	18.2	14.2	17.4	31.0	-
Turnover ratios (x)						
Asset Turnover (Net Block)	3.9	4.3	4.7	4.8	5.2	-
Inventory / Sales (days)	32	37	36	30	25	-
Receivables (days)	40	33	34	29	28	-
Payables (days)	28	26	28	29	27	-
WC cycle (ex-cash) (days)	44	44	42	31	26	-

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