

SHEELA FOAM LTD

HOME IMPROVEMENT

HOLD

Target Price: Rs 1236

Q1FY20: Realization pressure limits benefit of falling raw material cost

In Q1FY20, Sheela foam Ltd. reported sales revenues of Rs 514 cr (up 2% YoY & down 4% QoQ), EBIDTA of Rs 62 cr grew strongly by 23% YoY & 12% QoQ. EBIDTA margin at 12.1 % was back to normal after being subdued in last two quarter due to one off marketing expenses. Profit of Rs 39 cr was up 19% on yearly basis but remain flat on quarterly basis.

Revenue growth was flat during the quarter on back of de-growth in non-mattress segment due to tight financial conditions & slowdown in auto industry (largest target market in B2B sales). Realization fell sharply for non-mattress product sales (~65%) as SFL had to pass on partial benefits of falling raw material price (TDI). Blended realization of mattress segment also fell due to strong volume growth from economy models mattress. Margins improvement was largely driven by sharp fall in TDI as SFL maintained its selling price in mattress segment thus giving boost to Ebitda. TDI prices has seen steep correction to the level of Rs 154/kg and the benefits of the same has started to show up from Q1FY20. Growth in operating profit was offset sequentially by higher tax charges due to expiry of tax exemption on a plant.

CMP : Rs 1141
Potential Upside : 8%

MARKET DATA

No. of Shares : 4.88 cr
Market Cap : Rs 5583 cr
52-week High / Low : Rs 1817/ Rs 1140
Avg. Daily vol. (6mth) : 16,410 shares
Bloomberg Code : SFL IN
Reuters Code : SHEF.NS
BSE Code : 540203
NSE Code : SFL

Valuation

Sheela Foam is amongst the top 3 players in the industry and expected to be big beneficiary of the shift in taste following urbanization and changing lifestyle. We observe that shift from unorganized to organized segment is captured largely by economy level mattress whereas superior brands like 'Sleepwell' is lagging behind in this transition. Sheela foam has introduced two economy level mattress brands which is leading the volume growth at present. Going forward these brand would face immense pressure from highly competitive industry with very little product differentiation in the given price range. Additionally, e-commerce sales are majorly targeted by startups which are doing pretty well. TDI prices have corrected sharply and full benefits are expected to realize in coming quarter, however, on the backdrop of immense competition in the industry, slowdown observed in non-mattress segment and higher expense on aggressive marketing & sales strategies, we trim our FY20E revenue/PAT estimates by 7%/10% and reduce the rating to **HOLD**. We roll over EPS to FY21E to arrive at target price of **Rs 1236** (~ 35x multiple).

FINANCIAL SUMMARY (Consolidated)

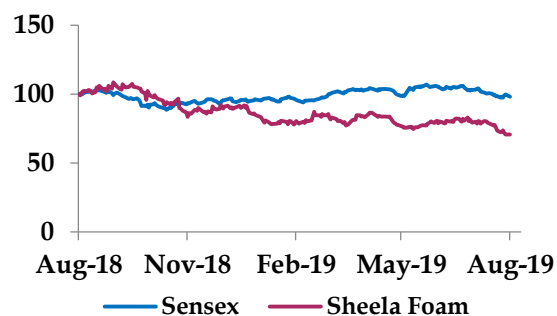
Y/E	Tot. Sales	PAT	EPS	Change	P/E	RoE	RoCE	EV/EBITDA	EBITDA
March	(Rs Cr)	(Rs Cr)	(Rs)	(YoY %)	(x)	(%)	(%)	(x)	(Rs)
2019	2141	134	27.4	0.0	46.3	20.2	26.6	29.5	209
2020E	2352	158	32.3	17.8	35.6	19.5	28.2	21.6	258
2021E	2631	172	35.3	9.3	32.6	17.7	24.9	19.0	273

Source: Company and Axis Securities

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PRICE PERFORMANCE



Key Highlights

- **Mattress volume up 32% YoY driven by economy model brands:** The mattress segment reported 10% YoY revenue growth and 32% YoY volume growth. Mattress volume sold in Q1FY19 was 4.27 lakh which has grown 32% YoY at 5.62 lakh in Q1FY20. Volume growth in mattress has been led by economy level mattress which led to fall in average realization of mattress. While strong growth in volume suggests a shift from unorganised to organised market in the mattress industry (~65% unorganised), we believe much of this opportunity would be captured by economy level brands as customer are very price sensitive. Therefore, we expect lower end brand of SFL i.e. 'Featherfoam' and 'Starlite' to continue contributing in the growth while the marquee brand 'Sleepwell' would continue to face pressure in the short term and growth to remain flattish.
- **Sharp fall in TDI prices, margins revival visible:** Ebitda margin during the quarter improved by 200 bps due to sharp fall in raw material (TDI) price since last 2-3 quarters. TDI prices have eased from Rs310/Kg in June'18 to average price of Rs 154/Kg in Q1FY20, the benefit of same could not be realised in previous quarters due to inventory carried by SFL and full benefit of correction in TDI is expected to occur from Q2FY20. Hence, we expect operating gross margins to improve in coming quarters which would be offset partially by higher marketing and selling expense due to increased competition and increase in effective tax rate due to expiry of tax exemption on one of the plant.
- **Relisation pressure limits margins growth:** Non-mattress segment that contributes around 65% to SFL sales faced realisation pressure as it has to pass on partial benefits of TDI correction to its B2B customers. Further, company is facing dearth of demand especially in automotive segment and the same is likely to continue unless economic slowdown picks up.
- **Geographic expansion via acquisition in Spain:** SFL has announced the acquisition of Interplast S. L., a Spain-based manufacturer of polyurethane foam, for EUR 42 mn, implies ~1.4x CY18 sales. The acquisition will help SFL to ramp up its presence in European market which is largest market for polyurethane foam. It has 1% market share in polytherene foam, thus, presenting large opportunity for growth. It has manufacturing capacity of 22,000 ton and is currently operating at 11,000 ton (~50%). SFL will set up a 100% subsidiary in Spain, which would acquire a 93.7% stake in Interplasp, the remainder would be held by three key managers of Interplasp with SFL having the right of first refusal.

Other Concall Highlights

- SFL is focusing on expansion with recent acquisition of Spain based 'Interplast' and has also purchased 30 acres of land in Jabalpur, India for greenfield project
- SFL is targeting online sales by endorsing 'Sleepx' brand which is performing well
- Employee expense during the quarter increased due to annual increment, quarterly bonus, new incentive scheme relative to incremental Ebitda performance of the company and restart of new plant to cater to additional volume demand during the quarter

Key Risk

- **Competition intensifies:** SFL is compelled to spend heavily in marketing and selling as their competitors are being backed by cash rich PE funds leading to intense competitive scenario

Results Update

(Rs. Cr)	Quarter ended					12 months ending		
	Q1FY20	Q1FY19	% Change (YoY)	Q4FY19	% Change (QoQ)	FY19	FY20E	FY21E
Sales	514	502	2	535	(4)	2141	2352	2631
Other Op. Inc	0.0	0.0		0		0	0	0
Total Revenue	514	502	2	535	(4)	2141	2352	2631
Expenditure								
Net Raw Material	260	275	(6)	266	(3)	1127	1262	1426
Personnel	61	44	38	45	37	177	200	224
Purchase of traded stock	7	7	(3)	4	92	47	45	50
Other Exp	124	125	(1)	164	(24)	581	588	659
Total Expenditure	452	451	0	479	(6)	1932	2094	2358
EBIDTA	62	51	23	56	12	209	258	273
Oth. Inc.	9.3	6.3	46	8.8	5	29	29	30
Interest	2.3	2.4	(3)	2.5	(7)	10	10	0
Depreciation	9.6	9.1	5	10.4	(8)	40	34	40
PBT	60	45	31	52	16	189	242	263
Tax	20.9	12.8	63	13.7	53	56	85	92
PAT	38.7	32.6	19	37.9	2	134	158	171
EPS (Rs.)	7.94	6.86	16	7.8	2	27	32	35

Source: Company and Axis Securities

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