

Company Research
17 July 2023 23:35 HKT

First Take

Sheela Foam Ltd (SHEF.NS)

BUY

Price: INR1188

Target: INR1420

Forecast Total Return: 19.5%

India | Construction & Materials

Event: SFL goes the whole hog

Event

- Sheela Foam (SFL) to acquire 96.55% stake in Kurlon (KEL) for Rs20.35b and a 35% stake in Furlenco for Rs3b, i.e. total cash outgo of Rs23.35b. The aforesaid transaction will not require CCI approvals and indicative timelines for deal conclusion are KEL/Furlenco are 30th Nov/Aug'23 respectively.

Rationale

- Kurlon:** a) **Complementing geographic reach / brand strength:** SFL is market leader in North & West, whereas KEL enjoys strong presence in the South and East, thereby complementing brand strength. b) **Widens leadership across product categories:** SFL's strength lies in foam, whereas KEL's strength lies in rubberized coir. Both companies are leaders in their respective categories. c) **Complementary distribution network:** SFL's distribution strength lies in EBOs, whereas KEL's distribution is via MBOs. d) **Consolidation** and right execution to strengthen distribution, yield production and operational efficiencies (logistics costs, sourcing, etc).
- Furlenco:** a) SFL **enters** the fast-growing **branded furniture and furniture rental market**, b) can leverage Furlenco's digital and design capabilities, c) potentially also aid cross sell, selling Furlenco's products via SFL+KEL network, d) SFL-Furlenco can offer Refurbishment as a Service (RaaS) for furniture.

Our view

- We highlight consolidation as a positive for the space (link to [note](#)). We see this transaction as potentially housing two leading brands under one management, offering room to make good on both brands complementary regional brand pull, geographical/distribution reach, and product offering, which could propel volume growth. Further, potential cost / synergy gains on operational front, including logistics, sourcing, rationalization on warehouses/manufacturing facilities, dealer margins could translate into margin accretion. Cumulative cash outgo stands Rs23.35b, and basis current B/S ratios on pro-forma basis we don't rule out company resorting to mix of debt and equity to raise this.
- Questions for management:** a) Will both brands co-exist and how? b) market sizing of foam / coir at regional level, c) roadmap on volume growth trajectory / margin accretion profile along with timelines, d) timelines/pricing on buyout of residual stake in both entities (if at all), e) source of funds (debt /equity), f) any golden handcuff, stock options to SFL, KEL management to ensure continuity and performance.

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Financials and Valuation

	2021A	2022A	2023A	2024E	2025E
Revenue (INRm)	24,354	29,818	28,733	30,943	33,410
EBITDA (INRm)	3,623	3,149	2,973	3,713	4,009
PBT (normalised) (INRm)	3,238	2,964	2,731	3,539	4,152
EPS (norm. cont.) - FD (INR)	48.7	22.3	20.7	26.9	31.6
DPS (INR)	0.0	0.0	0.0	0.0	0.0
PE (normalised) (x)	24.4	53.3	57.5	44.2	37.6
EV/EBITDA (x)	30.6	35.2	37.3	29.8	27.6
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

Target Price Basis

FY25 PE

Key Risks

RM volatility, failure to scale up exports, slowdown in domestic demand, high competitive intensity

Source: Company accounts/Investec Securities estimates



Kurlon Limited

Company background: Kurlon started commercial operations in 1962 and is the second largest manufacturer of rubberised coir, latex foam, polyurethane foam, spring mattress and furniture in India. As per filings, Kurlon is a pan-India player with a retail reach of 4000+ counters, 50+ warehouses and 12 manufacturing facilities across Karnataka, Orissa, Madhya Pradesh, Uttaranchal and Gujarat. Over FY16-22, Kurlon reported flattish revenue growth ((2)% CAGR) and average EBITDA margins of ~12%. For FY22, Kurlon's reported revenue/EBITDA was at Rs8024/107m with net cash position of Rs1.33b. Kurlon saw a PE infusion in 2015, 10% stake at Rs900m.

Furlenco

Company background: Furlenco is India's largest furniture rental and subscription business. The company also offers sale of new and refurbished furniture under its Furlenco & Prava brands. It is a leading furniture rental company with a strong online presence, and is also growing in the offline segment. Apart from rental, it also offers sale of furniture. It operates in major cities across India such as Bangalore, Mumbai, Delhi NCR, etc with a vision to be the one-stop furniture solution for new-age customers.

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	Expected total return	Count	All stocks	Corporate stocks	
	12m performance		% of total	Count	% of total
Buy	greater than 10%	289	79%	112	39%
Hold	0% to 10%	58	16%	1	2%
Sell	less than 0%	21	6%	0	0%

Source: Investec Securities estimates

Stock ratings for Indian stocks

	Expected total return	Count	All stocks	Corporate stocks	
	12m performance		% of total	Count	% of total
Buy	greater than 15%	129	56%	1	1%
Hold	5% to 15%	64	28%	0	0%
Sell	less than 5%	36	16%	0	0%

Source: Investec Securities estimates

Stock ratings for African* stocks

	Expected total return	Count	All stocks	Corporate stocks	
	12m performance		% of total	Count	% of total
Buy	greater than 15%	42	53%	13	31%
Hold	5% to 15%	18	23%	5	28%
Sell	less than 5%	20	25%	4	20%

Source: Investec Securities estimates

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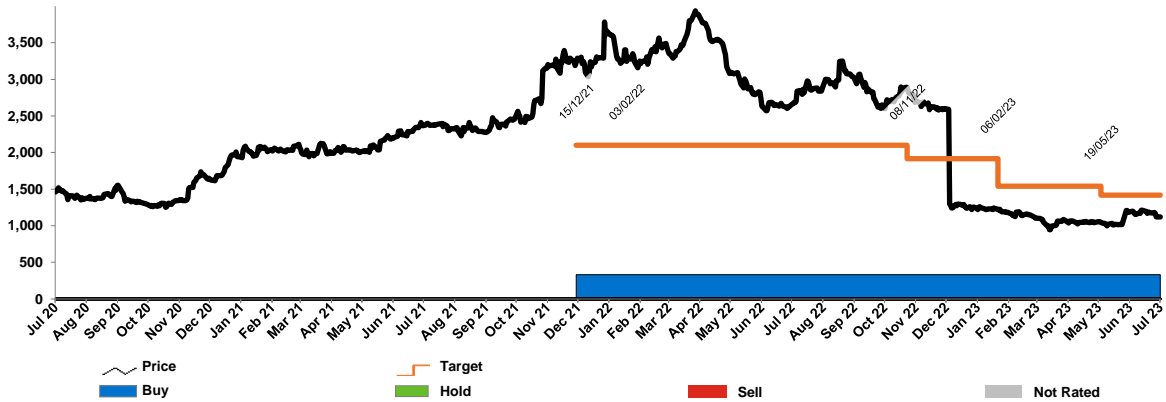
Sheela Foam

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Source: Investec Securities / FactSet

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