

Sheela Foam Ltd.

Improved prospects with inorganic growth

Sheela Foam Ltd. (SFL) registered sales of Rs. 6,132 Mn, recording a decline of ~15% on a YoY basis, on the back of delayed festive season and reduced raw material prices, which is subject to a pass-on on over 70% of the Company's business. The operating profit for the quarter reduced by ~15% on a YoY basis, on the back of reduced volumes, especially in the Indian market, by ~25% for mattresses, ~10% for Furniture Foam and ~8% for Comfort Foam on a YoY basis. The overall Indian business reported a fall of ~22% in revenue and 110 bps on EBITDA margin on a YoY basis. The Spanish business underwent competitive pressure and recorded a decline of ~5% in revenue and ~400 bps in EBITDA margin on a YoY basis. The Australian subsidiary reported a flat growth in revenue and a decline of ~220 bps in EBITDA margin on a YoY basis. During the quarter, the management appointed Mr. Tushar Gautam as the new Managing Director.

Addition of Kurlon

With the acquisition of Kurlon, the management aims to recover the subsidiary from the covid-impeding strategies and grow from a revenue base of ~Rs. 8,500 in FY23 Mn to ~Rs. 1,000 Mn in FY25, reverting its operating margins to ~11.5-12%. The management has identified several points of synergies, like leveraging the geographies of both Sleepwell and Kurlon, where either of them have been weak. Further, with the increased footprint, the combined entity will benefit from reduced delivery time and cost of transportation per unit by ~10-15%. Moreover, the management quantifies the operating profit to increase by at least ~100-150 bps. The synergies are anticipated to become visible by Q4 FY24.

The standalone growth levers

The Company has ventured to increase its Total Addressable Market (TAM) with the idea of serving mattresses to ~63% of Indians who are still void of the experience of sleeping on a mattress. The Company has built a plant in Jabalpur to cater to this idea, which is anticipated to be commissioned by Dec'23. The manufacturing capacity of this plant is so huge that it can cater to half of India's mattress needs. Further, its manufacturing technology reduces the cost of foam by ~15-20%. With this product, under the brand 'Tarang', the Company will serve small towns and talukas via the small-town distribution system, as against the top-tier distribution system via EBOs and MBOs. In addition to this, the Company also aims to capitalize on the transition from the unorganised to the organised segment. During FY23, ~63% of the market was unbranded.

View & Valuation

As a result of these rationales, we revise our estimates and maintain our rating of UNDER REVIEW, backed by the unavailability of Kurlon's financial statements. We'll provide our perspective after acquiring the consolidated financial statements.

6th November 2023

UNDER REVIEW

CMP: 1,079

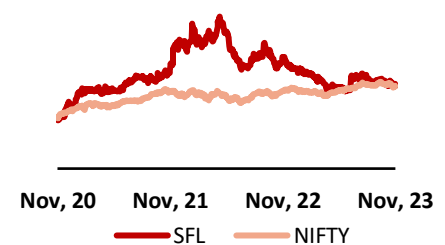
Company Data

Bloomberg Code	SFL IN
MCAP (Rs. Mn)	1,17,611
O/S Shares (Mn)	109
52w High/Low	1,497/906
Face Value (in Rs.)	5
Liquidity (3M) (Rs. Mn)	98

Shareholding Pattern %

	Sep-23	Jun-23	Mar-23
Promoters	65.48	72.95	72.95
FII's	6.04	3.21	3.26
DII's	25.08	21.95	22.28
Non-Institutional	3.4	1.89	1.5

SFL vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY23	FY24E	FY25E
Revenue	29	27	31
EBITDA	3	3	4
Net Profit	2	2	3
Total Assets	28	42	46
ROCE (%)	12%	10%	9%
ROE (%)	13%	9%	9%

Source: Company, Keynote Capitals Ltd.

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Q2 FY24 Result Update

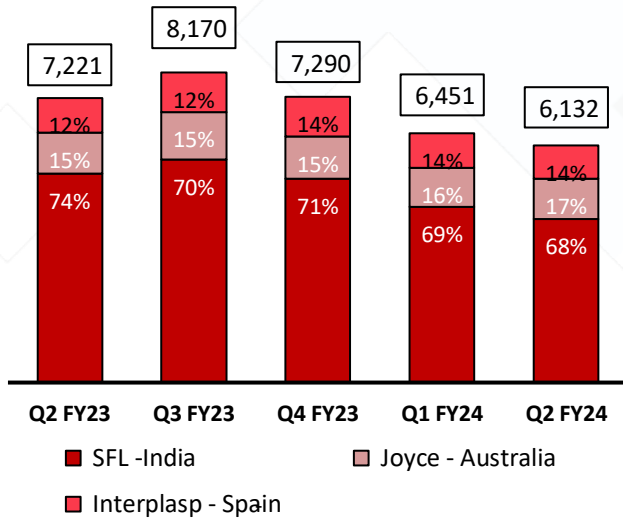
Result Highlights (Rs. in Mn)

Particulars	Q2 FY24	Q2 FY23	Change % (Y-o-Y)	Q1 FY24	Change % (Q-o-Q)	H1 FY24	H1 FY23	Change % (Y-o-Y)	FY23
Revenue	6,132	6,827	-10%	6,451	-5%	12,583	13,834	-9%	28,733
COGS	3,821	4,286	-11%	4,145	-8%	7,966	9,009	-12%	17,869
Gross Profit	2,311	2,541	-9%	2,306	0%	4,616	4,825	-4%	10,865
Gross Margin (%)	38%	37%	47 bps	36%	194 bps	37%	35%	181 bps	38%
Employees Benefit Expense	780	676	15%	732	7%	1,512	1,366	11%	2,792
Other Expenses	868	1,082	-20%	797	9%	1,665	2,018	-17%	5,100
EBITDA	663	783	-15%	777	-15%	1,439	1,442	0%	2,973
EBITDA Margin (%)	11%	11%	-66 bps	12%	-123 bps	11%	10%	101 bps	10%
Depreciation	219	205	7%	227	-3%	445	412	8%	896
EBIT	444	578	-23%	550	-19%	993	1,030	-4%	2,077
Finance Cost	86	45	91%	79	9%	164	93	77%	211
Other Income	244	220	11%	242	1%	486	400	22%	865
PBT	602	753	-20%	713	-16%	1,315	1,337	-2%	2,731
Exceptional Items	0	-	-	110	-	110	-	-	0%
Tax	156	217	-28%	170	-8%	326	376	-13%	700
PAT	446	536	-17%	434	3%	879	961	-9%	2,031
EPS	4.48	5.49	-18%	4.41	2%	8.90	9.85	-10%	20.81

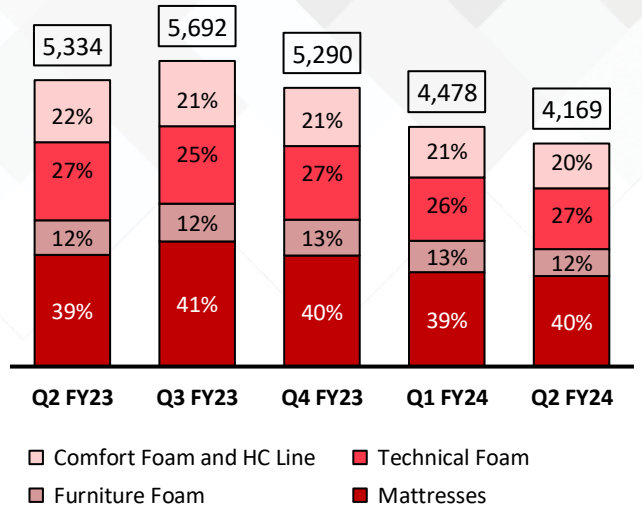
Source: Company, Keynote Capitals Ltd.

Quarterly business progression

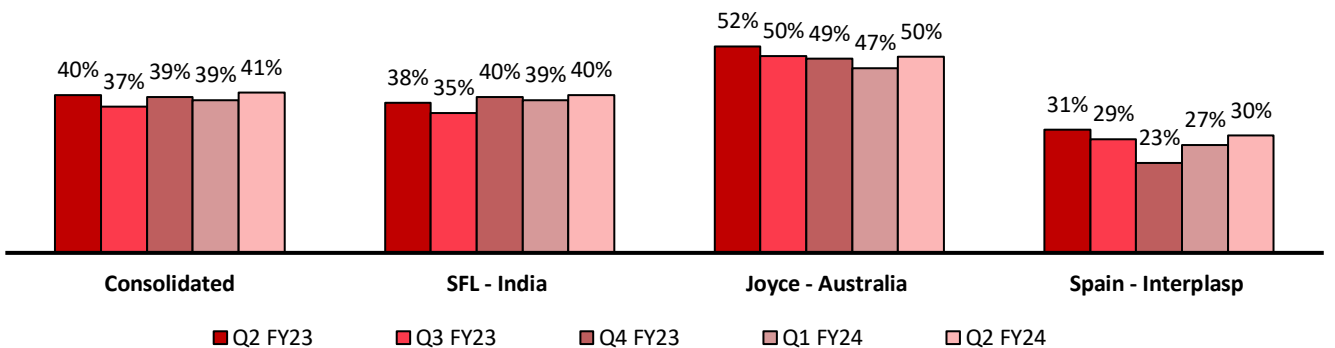
Consolidated Revenue (Rs. Mn) and Mix (%)



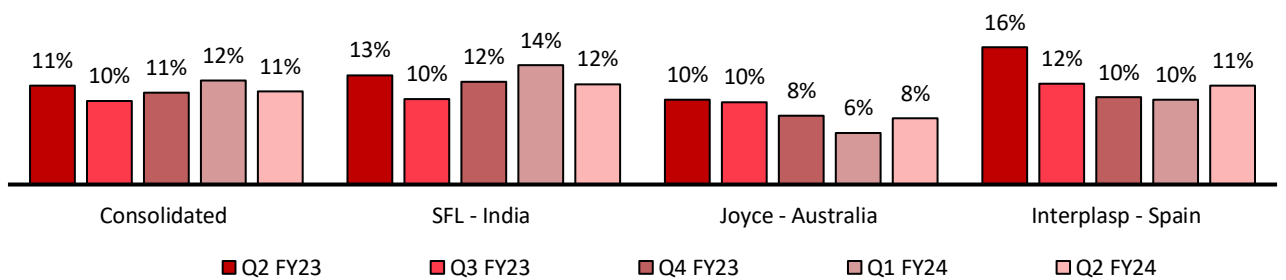
India Revenue (Rs. Mn) and Mix (%)



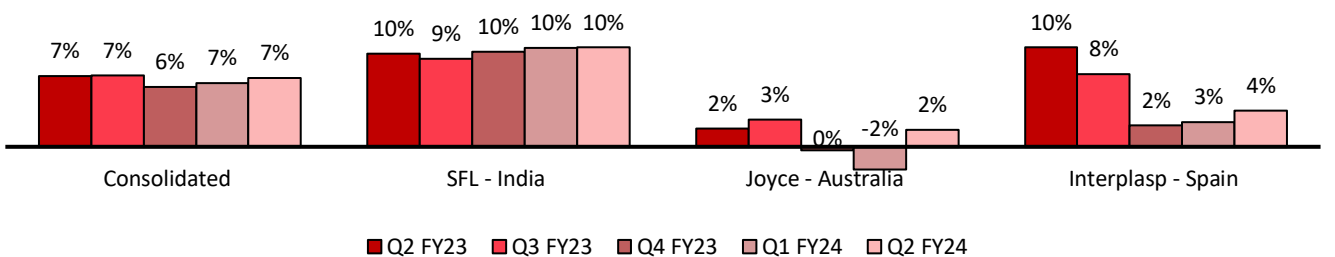
Gross Margin (%)



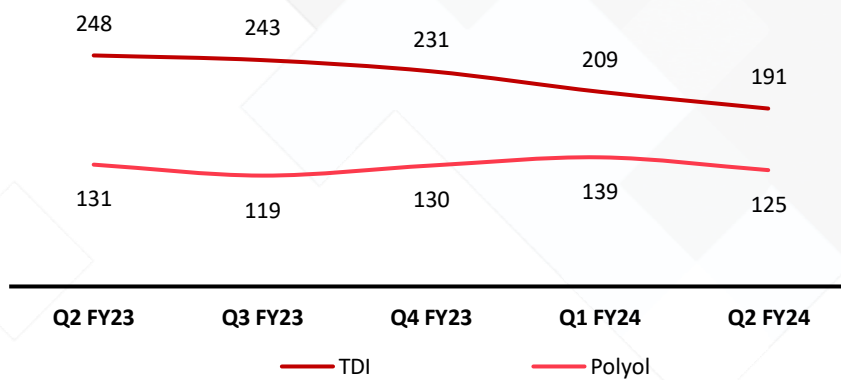
EBITDA Margin (%)



PAT Margin (%)



Raw Material Price Trend (Rs./Kg)



Source: Company, Keynote Capitals Ltd.

Q2 FY24 Conference Call Takeaways

Sheela Foam

- Revenues declined 10% on a YoY basis due to the delayed festive season, loss of sales from the SleepX brand, and reduced raw material prices.
- The online brand, SleepX had an annual revenue rate of ~Rs. 1,200 Mn before its strategic withdrawal from the trade channel. Post this action, ~Rs. 450-500 Mn or ~33% value and ~45% volume of SleepX have been recouped from Sleepwell brand via the e-commerce channel. As of Q2 FY24, the Company has an annual run rate of loss of ~Rs. 800 Mn or quarterly run rate of ~Rs. 200 Mn from SleepX. However, with increasing adoption of Sleepwell brand, this loss has been reducing on a month-on-month basis.
- The Company launched a new brand 'Nexa', which is a better and more evolved version of memory foam mattresses, at a price point of ~Rs. 25,000.
- The Jabalpur plant dedicated to manufacture mattresses for every Indian and has a massive capacity to cater to almost half of India's mattress requirements; it is anticipated to roll out its first production of the brand 'Tarang' by December'23.
- 'Tarang' is targeted to the rural and lower sections of semi-urban cities, where the Company will adopt a small-town-distribution system practised by FMCG companies. In this system, a truck loaded with a variety of products, distributes products in tehsils, talukas and ~600-700 districts covered by SFL. One benefit that Tarang gives is that it can be compressed, which makes the experience of distribution more convenient. Further, its technology of manufacturing reduces the cost of foam by ~15-20%.
- The management anticipates clock revenue of ~Rs. 3 Bn annually from 'Tarang' by FY26.
- The two overseas plants in Australia and Spain are anticipated to be commissioned in December'23.
- On the back of reduced raw material prices, the Company's contribution margin for the quarter improved by ~22 bps; however, the operating margins were reduced by 66 bps due to lower volumes on a YoY basis.

SFL | Quarterly Update

- The Spanish and Australian subsidiaries reported EBITDA margin of ~11% and ~8%, respectively in Q2 FY24. The management believes that sustainable margins are mid-to-high teens in these markets.
- The mix of standard and custom-made mattresses stands at ~65:35, requiring the need to maintain inventory accordingly.

Kurlon

- The management has identified a few backend and front-end synergies, such as economical raw material procurement, improving chemistry and formulation of manufacturing foam by Kurlon and increasing their yield. Further, with an increased footprint across the country, the delivery time is expected to reduce, which is a considerable point in the industry. The management has quantified that this could lead to an improvement in operating margin by ~100-150 bps. Furthermore, the management guides the transport cost per unit to reduce by ~10-15%. The synergies between the two companies are anticipated to become visible by Q4FY24.
- The management plans to minimize the cannibalization effect between the two brands by sharpening their brand positioning. The Sleepwell brand will represent technology, innovation and comfort, while the Kurlon brand will stand for natural and recyclable products.
- The Company recorded a revenue of ~Rs. 8,500 Mn in FY23 and the aims to grow to ~Rs. 10,000 Mn by FY25, implying a CAGR of ~8% and operating margins to ~11-12%, which Kurlon could obtain on a standalone basis.

Furlenco

- The Company repaid ~89% or ~Rs. 2,250 Mn of their outstanding debt, reducing their interest expense by ~60%. Further, the Company plans to repay the remaining debt by December'23.
- The startup became EBITDA-positive in Q2 FY24 as guided in the previous quarter and is in the direction to become PBT-positive by December'23 and register double-digit PBT margins in the following 3 years.
- With the Company becoming PBT positive by December'23, Furlenco plans to build assets that had been procrastinated since last year due to paucity of capital. Subsequently, the Company plans to leverage its digital, designing and manufacturing capabilities in an optimal manner so that Furlenco could enter new geographical areas sooner than its peers.
- The Company recorded revenue from the rental business, ~Rs. 1,560 Mn in FY23 (~95% of the business), on an asset base of ~Rs. 3,000 Mn. The management aims to clock a turnover of ~Rs. 3,000 Mn by FY25 from this segment.
- Between rental and sales segments, the management aims to bring the mix to 50:50 in the long run.
- With SFL becoming a house of brands, the management plans to leverage at least ~20% of SFL and Kurlon stores to showcase Furlenco furniture.
- During the quarter, the Company opened two retail outlets as the management believes that furniture is an item to experience before purchase.

Financial Statement Analysis (excluding Kurlon and Furlenco)

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	29,818	28,733	27,297	30,572	34,241
Growth %		-4%	-5%	12%	12%
Raw Material Expenses	17,667	17,093	16,514	18,343	20,544
Employee Expenses	2,577	2,792	3,003	3,363	3,766
Other Expenses	6,425	5,876	4,504	5,044	5,650
EBITDA	3,149	2,973	3,276	3,822	4,280
Growth %		-6%	10%	17%	12%
Margin%	11%	10%	12%	13%	13%
Depreciation	808	896	908	982	1,061
EBIT	2,342	2,077	2,368	2,839	3,219
Growth %		-11%	14%	20%	13%
Margin%	8%	7%	9%	9%	9%
Interest Paid	170	211	378	378	378
Other Income & exceptional	792	865	968	1,184	1,401
PBT	2,964	2,731	2,958	3,646	4,243
Tax	776	700	739	911	1,061
PAT	2,187	2,031	2,218	2,734	3,182
Others (Minorities, Associates)	-14	-19	-19	-19	-19
Net Profit	2,173	2,012	2,199	2,715	3,163
Growth %		-7%	9%	23%	16%
Shares (Mn)	48.8	48.8	54.3	54.3	54.3
EPS	22.28	20.62	20.23	24.98	29.10

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	411	425	2,857	5,230	7,856
Current Investments	894	7,120	15,520	15,520	15,520
Debtors	2,850	2,820	2,593	2,904	3,253
Inventory	3,145	3,313	2,973	3,302	3,698
Short Term Loans & Advances	570	575	575	575	575
Other Current Assets	343	86	86	86	86
Total Current Assets	8,213	14,339	24,603	27,617	30,988
Net Block & CWIP	9,468	11,525	11,709	11,797	11,934
Long Term Investments	5,850	564	4,164	4,164	4,164
Other Non-current Assets	2,680	1,946	1,946	1,946	1,946
Total Assets	26,211	28,374	42,422	45,523	49,032
Creditors	3,013	2,594	2,426	2,801	3,141
Provision	25	223	223	223	223
Short Term Borrowings	1,096	193	193	193	193
Other Current Liabilities	1,452	3,830	3,830	3,830	3,830
Total Current Liabilities	5,586	6,840	6,672	7,047	7,387
Long Term Debt	2,282	2,838	2,838	2,838	2,838
Deferred Tax Liabilities	18	-54	-54	-54	-54
Other Long-Term Liabilities	4,322	2,663	2,663	2,663	2,663
Total Non-Current Liabilities	6,623	5,448	5,448	5,448	5,448
Paid-up Capital	244	488	543	543	543
Reserves & Surplus	13,682	15,516	29,657	32,364	35,514
Shareholders' Equity	13,926	16,004	30,200	32,907	36,058
Non-Controlling Interest	76	83	102	121	140
Total Equity & Liabilities	26,211	28,374	42,422	45,523	49,032

Source: Company, Keynote Capitals Ltd. estimates

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	2,964	2,731	2,958	3,646	4,243
Adjustments	540	744	337	195	57
Change in Working Capital	-589	-548	399	-266	-405
Total Tax Paid	-943	-807	-739	-911	-1,061
Cash flow from operating Activities	1,971	2,120	2,954	2,664	2,834
Net Capital Expenditure	-1,429	-2,099	-1,092	-1,070	-1,198
Change in investments	-1,992	-1,266	-12,000	0	0
Other investing activities	357	682	968	1,184	1,401
Cash flow from investing activities	-3,064	-2,684	-12,124	114	202
Equity raised / (repaid)	0	-5	12000	0	0
Debt raised / (repaid)	1,321	1,041	0	0	0
Dividend (incl. tax)	-37	-28	-22	-27	-32
Other financing activities	-357	-451	-378	-378	-378
Cash flow from financing activities	927	556	11,600	-405	-409
Net Change in cash	-166	-7	2,431	2,373	2,627

Valuation Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	22	21	20	25	29
Growth %		-7%	-2%	23%	16%
Book Value Per Share	285	330	558	608	666
Return Ratios					
Return on Assets (%)	8%	7%	6%	6%	7%
Return on Equity (%)	17%	13%	9%	9%	9%
Return on Capital Employed (%)	14%	12%	10%	9%	9%
Turnover Ratios					
Asset Turnover (x)	1.1	1.1	0.8	0.7	0.7
Sales / Gross Block (x)	2.6	2.3	2.1	2.1	2.2
Working Capital / Sales (x)	9%	18%	47%	63%	64%
Receivable Days	36	36	36	33	33
Inventory Days	65	69	69	62	62
Payable Days	65	59	57	51	52
Working Capital Days	36	46	49	44	43
Liquidity Ratios					
Current Ratio (x)	1.5	2.1	3.7	3.9	4.2
Interest Coverage Ratio (x)	18.5	14.0	8.8	10.7	12.2
Total Debt to Equity	0.2	0.2	0.1	0.1	0.1
Net Debt to Equity	0.2	0.2	0.0	-0.1	-0.1
Valuation					
PE (x)	78.0	49.2	50.1	40.6	34.8
Earnings Yield (%)	1%	2%	2%	2%	3%
Price to Sales (x)	5.7	3.4	3.6	3.2	2.9
Price to Book (x)	12.2	6.2	3.3	3.0	2.7
EV/EBITDA (x)	54.8	34.3	31.1	26.7	23.8
EV/Sales (x)	5.8	3.5	3.7	3.3	3.0

KEYNOTE Rating History

Date	Rating	Market Price at Recommendation	Upside/Downside
12 th June 2023	BUY	1,025	+28%
7 th August 2023	UNDER REVIEW	1,150	-
6 th November 2023	UNDER REVIEW	1,079	-

Source: Company, Keynote Capitals Ltd. estimates

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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