

SHEELA FOAM LTD

HOME IMPROVEMENT

BUY

Target Price: Rs 1574

Q3FY19: Sluggish quarter, growth opportunity ahead with uptrend in margins

In Q3FY19, Sheela foam Ltd. reported sales revenues of Rs 569 cr (up 7% YoY & 6% QoQ), EBIDTA of Rs 61 cr was flat YoY but witnessed 44% QoQ growth on account of low base. EBIDTA margin at 10.7 % was back to normal after being subdued in last quarter due to one off marketing expenses. Profit of Rs 39 cr was flat on yearly basis but grew 63% on quarterly basis.

Revenue growth was led by 11% YoY mattress volume growth which was lower than expectation for the quarter due to tight financial conditions, slowdown in auto industry (largest target market in B2B sales) and marriage season falling comparatively shorter. Margins returned close to normalcy sequentially but EBITDA growth on yearly basis was flat due to two month inventory of major raw material (TDI) leading to higher average cost of TDI at Rs 255/kg while SFL passed TDI price cut benefits to B2B products. TDI prices has seen steep correction to the level of Rs 160/kg and the benefits of the same would be visible in Q4FY19 and FY20. We expect margins to improve in coming quarter and volume growth to be in-line, thus maintain **BUY** on the stock.

CMP : Rs 1300
Potential Upside : 21 %

MARKET DATA

No. of Shares : 4.88 cr
Market Cap : Rs 6344 cr
52-week High / Low : Rs 1850/ Rs 1230
Avg. Daily vol. (6mth) : 1,061 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. SFL would be riding the growth wave due to shift from unorganized to organized segment, product innovation and under penetration. Aggressive marketing & sales strategies along with new economy model mattress would help SFL increase its market share while sharp correction in TDI prices would boost its bottom line. All the turbulences seems to be behind SFL and growth opportunity remains intact. However, on the backdrop of weak Q2 margins and muted growth in Q3, we trim our top-line estimates for FY19/20E by 1%/1% and FY19/20E EPS by 14%/20%. We maintain **BUY** rating on the stock with revised target price of **Rs 1574**.

Key Highlights

Sharp correction in TDI prices to improve margins: The price of TDI, one of the critical raw materials was at Rs 250/Kg at the beginning of the quarter, it went down to Rs.160 per kg by the end of the quarter. However due to inventory of raw material which SFL carries, benefits of such correction was not visible as average price of TDI for SFL during the quarter stood at Rs 255/Kg. Fall in TDI prices is expected to normalize around lower side of current price i.e. Rs 154/Kg and management expects average procurement cost of TDI to be around Rs 190/Kg for Q4 which represents fall of 25% and would give a significant boost to the margins and bottom line.

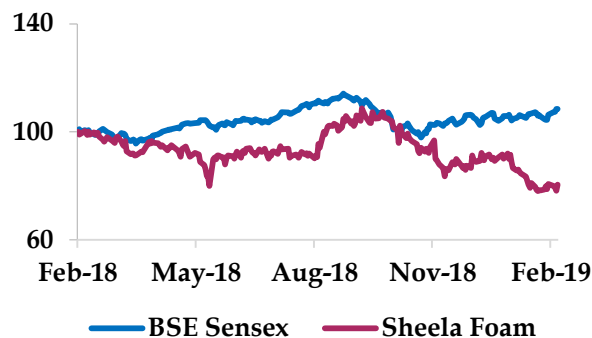
FINANCIAL SUMMARY (Consolidated)

Y/E	Tot. Sales (Rs Cr)	PAT (Rs Cr)	EPS (Rs)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	EBITDA (Rs)
2018	2004	134	27.4	7.1	-	25.2	33.2	-	216
2019E	2187	145	29.6	8.1	42.9	21.6	29.0	25.5	235
2020E	2455	192	39.3	32.8	33.0	22.9	31.4	19.6	308

Source: Company and Axis Securities

Key Drivers	FY19E			FY20E		
	Old	New	Change	Old	New	Change
Sales	2202	2187	-1%	2478	2455	-1%
PAT	167	145	-14%	239	192	-20%
EBITDA Margin (%)	12.2%	10.7%	150bps	15.1%	12.6%	250bps

PRICE PERFORMANCE



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Key Highlights (Cont'd)

Rapid expansion of Exclusive Brand Outlets: SFL has been spending aggressively to convert Multi-brand outlets (MBOs) to Exclusive brand outlets (EBOs). Company has revised the target to reach 5000 EBOs by March 2020, it has already achieved 3800 EBO as of 31st December 2018 with more than 200 EBO addition during Q3FY19. Further, the Company is now focusing on tertiary sales and spending on improving the footfalls and the conversion rate in EBO. This resulted into flat EBITDA growth for the quarter.

Volumes exemplar of growth: SFL posted revenue growth of 7% YoY but volume growth was 11% led by strong mattress volume. Management has indicated that majority of growth in volumes came from its economy model brands "Starlite" and "Feather foam". Value growth was lower because company had to pass the benefits of reduction in TDI price for its Foam core and B2B segment. SFL does not pass the raw material price cut in its branded mattresses which would be leading the margins growth as benefits of TDI price cut is expected to occur from Q4 onwards.

Concall highlights

- The season was not as per expectations as company took the hit from tight financial conditions in Indian economy which restricted credit flow. SFL sells its B2B products largely to Auto Industry which witnessed slowdown in this quarter. Marriage season was comparatively shorter in Q3 and Q4 is expected to nullify the impact with extended marriage season. However in comparison with peers SFL has performed decent.
- Mattress volume has been growing significantly and management feels this to be indicative of the unorganized sector beginning to shift to the organized sector which they were expecting since the introduction of GST
- Polyol price remained within reasonable band as USD/INR did not witness much volatility this quarter
- During this quarter, Revenue from operations from Australia was reported at Rs 82 crores, compared to Rs. 81 crores in Q3FY18. The EBITDA increased to Rs. 9 crores from Rs 7 crores in previous quarter and PAT was reported at Rs 4 crores, doubled when compared to previous quarter
- SFL has invested in capacity addition as they commissioned foaming capacity in Jalpaiguri plant in Q2FY19. Mattress capacity will be increased in Greater Noida within next two quarters, Hyderabad and Erode plants will see capacity addition within a year. The two new greenfield plants in tier 2 cities is expected to be coming up in 2 years
- The growth in the furniture segment has been 9% YoY mainly because of fall in TDI price and market expectation to transfer the benefits for its B2B while SFL was holding 2 months inventory at higher price of TDI. The focus is on organising the furniture market by associating with carpenters & upholsters. SFL is working on its marketing plan to increase awareness for using quality foam in furniture

Key Risk

- 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		
	Q3FY19	Q3FY18	% Change (YoY)	Q2FY19	% Change (QoQ)	FY18	FY19E	FY20E
Sales	569	532	7	535	6	2004	2202	2478
Other Op. Inc	0.0	0.0		0.0		0	0	0
Total Revenue	569	532	7	535	6	2004	2202	2478
Expenditure								
Net Raw Material	292	289	1	293	(0)	1054	1128	1219
Personnel	44	41	7	44	(1)	163	183	206
Purchase of traded stock	29	9	219	7	292	40	44	47
Other Exp	143	131	9	148	(3)	531	579	632
Total Expenditure	508	471	8	493	3	1788	1934	2103
EBIDTA	61	61	(1)	42	44	216	268	375
Oth. Inc.	8.2	4.4	84	5.8	41	21	21	22
Interest	2.5	1.9	33	2.3	10	9	9	10
Depreciation	10.0	8.9	12	9.9	1	35	39	43
PBT	57	55	3	36	57	193	241	345
Tax	17.6	16.0	10	11.6	51	60	73	105
PAT	38.9	39.1	(0)	24.4	60	134	167	239
EPS (Rs.)	7.98	8.02	(0)	5.0	60	27	34	49

Source: Company and Axis Securities

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