



Sheela Foam Ltd. - IPO Note

Issue Details	
Issue Dates	29 th Nov, 2016 to 1 st Dec, 2016
Issue Type	Secondary Sale/OFS
Pre-Issue Equity Shares Outstanding	4.87 Cr
Post-Issue Equity Shares Outstanding	4.87 Cr
Issue Size at Upper Band	510 Cr Shares
Price Band	₹680 to ₹730
Market Cap at Upper Band	₹3,555 Cr
FY16 EBITDA	₹194 Cr
FY16 PAT	₹105 Cr
FY16 P/E at Upper Band	33.8x

About the Company:

- Founded in 1971 as a PU Foam manufacturer, later entered the branded foam mattress business, has a 20% to 23% market share in the organized mattress business pegged at ~INR 3000 Cr.
- Receives ~80% of its India revenues from the B2C channel (Bedding & furniture Business) while the other ~20% comes from the B2B technical foam business (Largely Automotive usage in seats etc., some amount of usage in furniture)
 - The Company's flagship "Sleepwell" brand accounts for ~60% of the B2C sales while the brands "Feather Foam" and "Lami Flex" account for the rest
- The business also acquired Joyce Foam a wholly owned subsidiary which is a mattress business in Australia and accounts for ~17% of the Company's revenues

Industry Overview:

- The Indian mattress industry size is pegged at ~INR 9000 Cr, of which ~35% is organized
 - Within the organized segment Kurlon & Sheela Foam occupy dominant positions having ~20 to 25% market share each
- Types of mattresses:

Type of Mattresses	(%) Share (Volume)	Dominant Player
PU Foam	50%	Sheela Foam, @Home
Rubberized Coir	30%	Kurlon, @Home
Spring	20%	Springwel, Springfit

- Industry Growth Rates:
 - The overall mattress industry has grown at a steady CAGR of ~8% per year, while the organized segment has grown at a CAGR of ~11%
 - Of the above ~3-4% is the typical price growth while the rest is volume growth.
 - Industry growth rates however are significantly below those of other home improvement products such as paints, tiles or sanitary ware:-
 - Management attributes the same to the inability to "show-off" mattresses as compared to the other sectors, and are sold based on comfort
- Industry Segments by usage:
 - ~85% of the industry sale is residential, which is largely urban, (low penetration of non -cotton mattresses in rural areas)
 - ~15% of industry sales are institutional where Luxury hotel chains (5 Stars) typically buy Spring Mattresses, Budget Hotels, 3 star hotels prefer PU Foam Mattresses(Sheela Foams Target). Rixin covered Rubberized Coir mattresses (Kurlon's Segment), are preferred by Hospitals.



- Industry Classification based on distribution channels:- (Organized Segment)

Distribution Channel	Revenue Share (%)
Third Party Distributors	88%
Own Stores	9%
Online	3%

- Market Classification by Price Segment:- (Organized Segment)

Segment	Price Range ₹	% Share (By Revenues)
Economy	0-8000	25%
Mid-Segment	8000-30000	50%
Premium	30000-75000	20%
Luxury Segment	75000+	5%

- Other Industry Data points:
 - The typical re-placement cycle is quite long at 8-10 years
 - Peak sales are observed in Q3 due to the advent of the wedding season, Q3 accounts for ~30-32% of annual sales while Q1, Q2 & Q4 have ~22%-23% of annual sales

View on the Company:

The Good:

- Market leader in a largely unorganized industry with the highest share of voice (Out-spends Kurlon by 2.0x to 3.0x on advertising spends)
- Raw materials are commodity products thus enabling a lean working capital cycle
 - High share of exclusive distribution (50+% of sales) which leaves the company with good bargaining power with the distribution channel (Franchisee Basis)

Distribution Mode	Number	Size
Exclusive Distributors	100	NA
Sleepwell World	218	1000 Sq.ft.
Sleepwell Galleries	402	600 Sq.ft
Sleepwell Shoppes	819	200 Sq.ft
Other Retail Dealers	560	NA
Multi Brand Outlets	2500	NA

- High Fixed asset turns at ~5x to 6x can go as high as ~10x at full capacity utilization
 - 11 facilities in India with a capacity of 123000 tons per annum, FY16 production stood at 42577. (Low capacity utilization ensuring negligible capex requirements going forward.
 - 5 facilities in Australia with a capacity of 10500 tons per annum (High utilization) however negligible volume growth thus no future cap-ex needed

The Bad:

- Raw material prices are highly co-related with crude oil prices (3-4 month Lag), any sharp rise in crude oil prices will impact margins heavily.
- The company is also disrupted by any disruptions in the supply chain which could cause share spikes in RM prices
- Key Suppliers:
 - GNFC:- the blast last month, disrupted prices and caused a ~20% rally in RM prices which have hence subsided
 - Mangalam Organics, the other large supplier to the company



Valuations & Recommendation:

The company is a debt free (net debt) company thus valued on a P/E basis

Price Band	Market Cap	P/E (FY16)
Lower 680	3311	31.5
Upper 730	3555	33.8

- The business is currently at peak cycle margins, with profitability linked to crude oil prices
- The entire margin improvement in FY16 has been driven by a reduction in RM costs, while all other costs have in-fact increased
- If one were to assume mid cycle ~8% EBITDA margins the current issue would be priced at over 50 times earnings which is extremely expensive for a business generating a 10-15% sales growth

View on Management & Corporate Governance:-

The Good:

- The company was founded by former Member of Parliament Sheela Gautam Aged 85. She was a 4 time Member of Parliament from Aligarh in Uttar Pradesh (INC, Later Joined BJP)
- The company does not need any external capital and generates surplus cash-flows
- The management pegs the reason for the share sale, carry out philanthropic activities

The Bad:

- A key reason for concern would be that the Sleepwell brand is owned by the family and licensed to the company until 2026 at an annual payment of INR 10 lac
- The CSR Donations of ~INR 1 Cr too are made to a trust controlled by the promoter entity "Sleepwell foundation"

Recommendation:

The underlying business generates robust free cash-flows at a high ROCE and has a good growth trajectory being the market leader in a highly un-organized sector.

However the asking price is too high at over ~50.0x mid cycle P/E (at 8% EBITDA Margins), we would thus recommend investors to avoid the issue and wait for better valuations in the secondary market.



Financials: India Standalone Operations

Particulars (₹ Cr)	FY12	FY13	FY14	FY15	FY16
Revenues	817	1001	1128	1272	1411
Growth (%)		23%	13%	13%	11%
Excise Duty	77	115	125	136	146
(%) Duty	9%	12%	11%	11%	10%
Other Income	6	12	8	14	21
Net Sales	745	898	1011	1150	1286
Material Cost	502	586	647	729	679
Purchase of Stock in Trade	9	7	9	12	14
Inventory Adjustments	-9	-11	-3	0	9
Total RM Cost	503	582	654	741	702
(%) of sales	67.5%	64.8%	64.7%	64.4%	54.6%
Other Manufacturing Expenses	24	28	37	53	64
(%) of sales	3.2%	3.1%	3.6%	4.6%	5.0%
Employee Expenses	31	44	60	68	81
(%) of sales	4.2%	4.9%	6.0%	5.9%	6.3%
Advertisement/Brand Expenses	20	25	28	41	59
(%) of sales	2.6%	2.7%	2.8%	3.5%	4.6%
Promotional Expenses	13	13	19	18	29
Sales Promotion Schemes	24	42	42	52	64
Sales Incentives & rebates	54	57	50	59	73
Total Sales Expenses	91	112	111	128	166
(%) of sales	12.2%	12.5%	11.0%	11.1%	12.9%
Other Expenses	35	40	56	42	52
(%) of sales	5%	4%	6%	4%	4%
EBITDA	42.52	67.85	63.72	77.72	162.04
(%) of sales	5.7%	7.6%	6.3%	6.8%	12.6%
Depreciation	14	19	20	22	23
Finance Costs	16	15	12	10	7
PBT	12	34	32	46	133
Taxes	4	10	7	11	42
Tax Rate (%)	34%	28%	21%	25%	32%
PAT	8	24	25	34	90
Operating Cash Flow	33.40	76.3	120.7	110.2	170.6
Cash From -ve Working Capital	11.20	33.00	75.50	54.30	57.70
Cap-ex	65.1	25	30	43	30
FCFF	(31.70)	51.30	90.70	67.20	140.60
Fixed Assets	160.10	172.3	181.4	198.5	203
FA Turnover	4.65	5.21	5.57	5.79	6.34
Inventory	57.7	85.3	86.2	91.1	73.5
Inventory Days	28	35	31	29	21
Payables	54.7	56.2	70.8	93.5	89.6
Payable Days	27	23	26	30	25
Receivables	81.5	75.8	80.7	78.2	74.9
Receivable Days	40	31	29	25	21
Working Capital Days	41	43	35	24	17
ROCE (%)	16%	21%	21%	24%	46%



Australia Business Statement

Particulars (₹ Cr)	FY12	FY13	FY14	FY15	FY16
Revenues	312	264	269	282	285
Growth (%)		-15%	2%	5%	1%
Excise Duty	6	0	0	0	0
(%) Duty	2%	0%	0%	0%	0%
Other Income	0	0	-2	-4	-4
Net Sales	305	264	266	278	281
Material Cost	153	110	122	126	130
Purchase of Stock in Trade	-3	0	0	0	0
Inventory Adjustments	-5	2	-1	5	-4
Total RM Cost	146	112	121	130	125
(%) of sales	47.7%	42.3%	45.5%	46.9%	44.6%
Other Manufacturing Expenses	12	11	11	10	10
(%) of sales	3.9%	4.1%	3.9%	3.5%	3.7%
Employee Expenses	62	59	59	61	59
(%) of sales	20.1%	22.3%	22.1%	21.8%	20.9%
Other Expenses	68	56	49	53	55
(%) of sales	22%	21%	18%	19%	20%
EBITDA	18.89	26.45	26.78	24.08	31.66
(%) of sales	6.2%	10.0%	10.1%	8.7%	11.3%
Depreciation	11	12	10	6	7
Finance Costs	8	8	7	6	5
PBT	0	6	10	12	20
Taxes	0	(1)	7	4	6
Tax Rate (%)	-43%	-9%	71%	32%	28%
PAT	0	7	3	8	15
Operating Cash Flow	26	21	3	37	6
Cash From -ve Working Capital	15.50	2.00	(9.30)	22.50	(15.30)
Cap-ex	-1	7	1	15	7
FCFF	27.10	13.70	2.60	21.80	(1.60)
Fixed Assets	109	97	88	96	94
FA Turnover	2.80	2.73	3.04	2.91	2.98
Inventory	34	31	38	27	31
Inventory Days	41	43	52	35	40
Payables	26	25	28	20	23
Payable Days	30	34	38	27	30
Receivables	34	29	39	36	42
Receivable Days	40	40	54	48	55
Working Capital Days	51	48	67	56	65
ROCE (%)	12%	21%	15%	15%	18%



Consolidated Statement

Particulars (₹ Cr)	FY12	FY13	FY14	FY15	FY16
Revenues	1128	1264	1396	1553	1696
Growth (%)		12%	10%	11%	9%
Excise Duty	83	115	125	136	146
(%) Duty	7%	9%	9%	9%	9%
Other Income	6	12	6	11	17
Net Sales	1051	1161	1277	1428	1567
Material Cost	656	696	769	855	809
Purchase of Stock in Trade	7	7	10	12	14
Inventory Adjustments	-14	-9	-4	4	4
Total RM Cost	649	694	775	871	828
(%) of sales	61.7%	59.7%	60.7%	61.0%	52.8%
Other Manufacturing Expenses	36	38	47	63	74
(%) of sales	3.4%	3.3%	3.7%	4.4%	4.7%
Employee Expenses	93	103	119	128	139
(%) of sales	8.8%	8.9%	9.3%	9.0%	8.9%
Other Expenses	213	232	244	264	332
(%) of sales	20%	20%	19%	18%	21%
EBITDA	61.41	94.30	90.50	101.80	193.70
(%) of sales	5.8%	8.1%	7.1%	7.1%	12.4%
Depreciation	25	31	30	28	29
Finance Costs	24	23	19	16	12
PBT	12	40	41	58	153
Taxes	4	9	14	15	48
Tax Rate (%)	35%	23%	33%	26%	32%
PAT	8	31	28	43	105
Operating Cash Flow	59.70	97.2	124	147.3	176.3
Cash From -ve Working Capital	26.70	35.00	66.20	76.80	42.40
Cap-ex	64.3	32.2	30.7	58.3	37.3
FCFF	(4.60)	65.00	93.30	89.00	139.00
Fixed Assets	269.20	269	269	294	297
FA Turnover	3.90	4.32	4.75	4.86	5.28
Inventory	91.7	116.1	124.1	118.1	104.6
Inventory Days	32	36	35	30	24
Payables	80.2	81	98.8	113.9	112.6
Payable Days	28	25	28	29	26
Receivables	115.3	104.4	120	114.4	117
Receivable Days	40	33	34	29	27
Working Capital Days	44	44	42	30	25
ROCE (%)	14%	21%	19%	21%	36%



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