

# Sheela Foam

## Strong demand tailwinds across geographies; RM headwinds also managed well

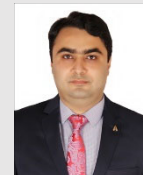
- ✓ **View** – Sheela Foam posted a very strong set of results with industry tailwinds driving demand across geographies and the company demonstrating strong cost controls to offset the impact of a sharp rise in input costs. While demand is expected to sustain going forward with new B2B opportunities also opening up, the correction in input prices is expected to provide a further fillip to margins going ahead. Limited capex requirements should also drive up return ratios going ahead. While increasing competition from online players remains a risk, we view Sheela Foam as a strong medium-term growth story and hence believe the premium valuations of 35x FY23E earnings should sustain and gradually improve going forward.
- ✓ **Result highlights** – Strong performance with revenue/EBITDA/PAT growth of 26%/53%/54% led by strong increase in demand for mattresses across India, Australia and Spain. Margins moved up despite input price led gross margin decline led by much lower selling and marketing expenses.
- ✓ **Key trends**- Sales shifting significantly towards e-commerce channel, more focus on health & hygiene, pandemic impact waning quickly in India; Australia enforcing strict controls while Spain facing difficulties in pandemic control.
- ✓ **Budget takeaways** – Overall view the budget as big positive with 3 potential opportunities for the company – extra budget for Railways, focus on affordable housing and purchase of more buses opens up more business opportunities.
- ✓ **Input costs** – High volatility seen in last 6 months, prices went up significantly and now started cooling off, polyols (20% of sales) below 200 and TDI (30% of sales) about 170 after touching highs of 230 per kg, should stabilize in the 150-170 range by end of February; Australia prices stable, Spain also did not increase much.
- ✓ **US Bed in a Box program opportunity** – 600mn USD Market primarily supplied by China, US looking at alternative options, strong enquiries, already begun supplying from India and Spain, should cross 100cr in FY22.
- ✓ **Mattress demand outlook** - Volume growth has positively surprised; Australia and Spain demand increased due to increased time at home, restricted imports from China and govt support; India demand growth led by increase in penetration from 30-35% with more consumers adopting mattresses given increased time at home and shift from unorganized players; expect demand momentum to sustain for entire industry with leading brands set to benefit most.
- ✓ **Margin outlook** – Lower marketing and selling expenses plus help from operating leverage helped increase margins to 17.5% from 14% in FY20 despite GMs falling to 43% from 49%; expect margins to sustain going forward.
- ✓ **International acquisition rationale** – Went to Australia given opportunities for cross learnings, common RM suppliers and a strong management; entered Spain in 2019 as wanted a foothold in EU, the world's largest PU foam market which is also a low cost alternative to cater to US.
- ✓ **Focus on value for money products** - Volume up 16% and price increase of only 2%; never want to pass on entire RM cost given volatility; lower value segment growing much faster given share gains from unorganized market.

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- ✓ **Pricing strategy** – Try and maintain contribution margins across B2C and B2B segments; B2C margins higher given pricing power; B2B business has long term contracts and a time lag in passing on price hikes.
- ✓ **Capex plans** – New plant coming up in Central India in Jabalpur plus maintenance capex in next 2-3 years of 40-45 crs
- ✓ **E commerce competition** – Players like Wakefit have done well but do not see any significant price disruption, will not indulge in any price competition, e commerce channel growing from a small base, hold No.2 position in that channel and target the top slot there as well.
- ✓ **Spain integration** – RM availability, pricing has been in turmoil in last few quarters; full integration which was delayed due to COVID should be complete by March in terms of IT and processes

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