17th August, 2023

To

The BSE Limited
Phiroze Jeejeebhoy Towers
Dalal Street, Mumbai-400001
Scrip Code: 540203

The National Stock Exchange India Limited
Exchange Plaza, Bandra Kurla Complex
Bandra(E), Mumbai-400051
NSE Symbol: SFL

Subject: Credit Rating

Dear Sir/Madam,

Pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we wish to inform you that India Ratings and Research (Ind-Ra) has assigned Sheela Foam Limited (SFL) a Long-Term Issuer Rating of 'IND AA' with a Stable Outlook. Please find enclosed the report on credit rating.

This is for your information and record.

Thanking you,

Yours truly,
For Sheela Foam Limited

Md Iquebal Ahmad

Digitally signed by Md Iquebal Ahmad
Date: 2023.08.17 19:32:50 +05'30'

Company Secretary & Compliance Officer

SHEELA FOAM LTD.
#14, Sleepwell Tower , Sector 135, Noida- 201301
Ph: Int-91(0)-120-4162200 • Fax: Int-91-(0)-120-4162282, 4162283 • Email: contactus@sheelafoam.com
Regd. Office: 604 Ashadeep, 9 Hailey Road, New Delhi-110001, India • Ph: Int-91(0)-11-22026875-76
Toll Free: 1800 103 6664 • www.sleepwellproducts.com • www.sheelafoam.com
CIN-L74899DL1971PLC005679

IndiaRatings & Research
A Fitch Group Company

Login

India Ratings Assign Sheela Foam 'IND AA'/Stable

Aug 17, 2023 | Furniture | Home Furnishing

India Ratings and Research (Ind-Ra) has assigned Sheela Foam Limited (SFL) a Long-Term Issuer Rating of 'IND AA' with a Stable Outlook.

Analytical approach: Ind-Ra considers a consolidated approach for SFL and its subsidiaries while arriving at the ratings because of the strong operational and strategic linkages among them.

On 17 July 2023, SFL announced that it plans to acquire 94.66% shares of Kurlon Enterprises Limited (KEL) and around 35% of House of Kieraya Pvt Ltd (Furlenco).

While arriving at the ratings, Ind-Ra has considered the pro-forma consolidated numbers of SFL post the acquisition of KEL as most of the regulatory approvals related to the KEL acquisition are in place and the acquisition is likely to be completed by November 2023. The Furlenco acquisition is likely to be completed by August 2023.

The ratings reflect SFL's strengthened market position in the Indian organised mattress segment, with a much larger scale of operations in terms of revenue and profitability as well as an improved distribution reach post the KEL acquisition. Ind-Ra takes into cognisance the low net adjusted leverage of under 1.0x maintained by the company since FY17; however, the same is likely to increase to over 2.5x in FY24 (FY23: net cash position) post the KEL acquisition. Nonetheless, Ind-Ra takes comfort from the fact that only a part of the acquisition will be debt funded, while a part being funded by internal accruals and the equity raise which is has already been approved by the board. Also, the company's ability to generate strong free cash amid the absence of any major capex might reduce the pressure on the credit metrics over the medium term, according to Ind-Ra.

Key Rating Drivers

Strengthened Market Position: SFL is the largest manufacturer of polyurethane foam (PU) foam and mattresses in India with its well-established brand SleepX. The company has a dominant position in other industries such as automotive, footwear, lingerie, and furniture, among others apart from mattresses. According to the management, SFL enjoys a market share of around 19% in the overall branded modern mattress segment in India. The company is acquiring KEL which is the among the leading players in the Indian mattress industry and a market leader in rubberised coir mattress. KEL holds a market share of around 11% in the modern mattress segment and operates with its brand Kurlon. Post the acquisition, the combined entity's market share in the overall industry will reach around 29% in the branded modern mattress market.

Ind-Ra opines SFL's market share will continue to benefit from a gradual shift to organised sector from the unorganised one, supported by increasing consumer awareness about the health benefits of quality mattresses.

Furthermore, SFL holds around 40% market share in Australia, being a flexible PU foam player through its subsidiary-Joyce Foam PTE (Australia).

Acquisition of KEL & Furlenco to Strengthen Business Profile: SFL manufactures PU foam mattresses and operates in India with a robust distribution network of over 5,600 exclusive brand outlets (EBOs), over 7,500 multi-brand outlets (MBOs) and 11 manufacturing facilities. The company generates around 74% of its revenue from the home comfort segment while 26% comes from the technical foam segment, where it supplies foam to a large set of industries. Geographically, the company derives 71% of its revenue from operations in India, 15% from Australia and 14% from Europe.

KEL operates with a distribution network of over 4,500 MBOs and 10 manufacturing facilities. While SFL has a stronger presence in north and west India, KEL has a stronger presence in east and south. The acquisition of KEL will help SFL to widen its market presence across India in the mattress industry with a wider distribution network while providing it the access to coir mattresses, thus diversifying its product portfolio.

Moreover, the Furlenco acquisition will provide cross selling opportunities for SFL and increase its reach in the furniture market.

Partly Debt-funded Acquisition to Impact Otherwise Robust Credit Metrics: The total consideration for these two acquisitions is around INR23,352 million, which will be funded through a mix of debt raised in the form of non-convertible debentures of INR6,000 million, equity raise through qualified institutional placement of INR10,000 million and the rest through internal accruals. SFL had strong cash balances of INR7,545 million at FYE23.

SFL's credit profile is robust with it being a net cash entity (considering lease liabilities) at FYE23 with a strong interest cover (EBITDA/interest expenses) of 14.1x, owing to its low debt, coupled with sustained EBITDA levels. SFL has a history of maintaining prudent financial discipline of keeping the debt/equity ratio below 1.0x even in case of the historical acquisitions. KEL's credit metrics were also healthy, with it being a net cash company at FYE22 with an interest cover of 3.4x; the company's credit metrics are likely to have remained healthy at FYE23.

However, given that both the acquisitions are likely to be partly debt-funded, SFL's consolidated net leverage could deteriorate to 2.3x-2.6x in FY24 (on pro-forma basis). Ind-Ra expects the net leverage to improve gradually in FY25, mainly on account of the full integration of KEL in FY25 resulting in better cash generation, the lower working capital requirement of the B2C business and SFL's limited capex plan. The interest coverage is likely to remain strong over FY24-FY25, supported by sustained EBITDA levels.

Scale of Operations to Improve post Acquisition: SFL recorded a revenue of INR28,733 million in FY23 (FY22: INR28,656 million). In 1QFY24, the company's revenue declined around 8% yoy to INR6,451 million, mainly on account of the discontinuation of its loss-making brand Sleep. KEL recorded a revenue of around INR7,952 million in FY22, which is likely to have increased at a low single digit yoy in FY23. With KEL's acquisition, organic growth in the market amid a continued shift to the organised market, along with the commencement and ramping up of SFL's variable pressure foaming (VPF) plant in 2HFY24, the pro-forma revenue for consolidated SFL is likely to be INR40,000-41,000 million in FY24 and is likely to increase further at 8%-10% yoy in FY25.

SFL's EBITDA margins reduced to 10.3% in FY23 (FY22: 11%), mainly on account of higher raw material prices. As raw material prices started to stabilise, the EBITDA margins increased to 12.0% in 1QFY24. KEL's EBITDA margins dropped to 2.4% in FY22; though is they are likely to have increased on a yoy basis in FY23, the margins are much lower compared to historical levels of 10%-14%. Ind-Ra expects the EBITDA margins on a pro-forma basis to be 9%-10% in FY24, while increasing further by over 100-150bp in FY25, mainly due to the benefits of the economies of scale, operational and distribution synergies.

SFL's consolidated return on capital employed dropped to 15.5% in FY23 (FY22: 20.1%) as the company undertook capex for the VPF plant, along with lower EBITDA margins. However, the same is likely to increase over the medium term on account of SFL's improving profitability and limited capex plans. SFL's consolidated net working capital cycle elongated to

49 days in FY23 (FY22: 37 days) as a result of reduced payables of 55 days (59 days) coupled with high inventory requirement of 68 days (61 days) as a result of volume increase. Ind-Ra expects the cycle to remain stable over the near-to-medium term.

Liquidity Indicator - Adequate: SFL held strong cash balances of INR7,545 million at FYE23. SFL has total working capital limits of around INR1,320 million, which remained largely unutilised for the 12 months ended July 2023. The company has been generating positive free cash flow (FCF; Ind-Ra-calculated) over the last decade (except in FY20 when the company funded an acquisition in Spain). In FY23, the consolidated FCF for SFL was recorded at INR337 million (FY22: INR433 million, FY21: INR1,802 million). KEL has been an FCF-positive company historically. Though KEL's FCF for FY22 was positive, it was muted at INR55 million on account of low EBITDA levels.it. In FY23, the FCF for KEL is likely to have remained largely in line with the FY22 levels with a slight improvement.

Given the low working capital requirement of the B2C segment (considering dealer deposits and advances), SFL's capex is likely to be limited to the extent of INR100 million-200 million over FY24-FY25 (FY23: INR2,116 million). Ind-Ra expects the free cash flow to remain positive over FY24-FY25. On a consolidated basis, SFL has total debt repayment obligations of around INR1,033 million in FY24 and INR1,082 million in FY25, which are likely to be met by internal accruals. While SFL's cash balance is likely to erode significantly amid acquisitions, the agency takes comfort from the company's ability to generate continued positive FCF and its access to debt-capital markets.

Strong Record of Acquisitions Historically: SFL has historically had a strong track record of completing acquisitions and generating benefits out of them. SFL had acquired Joyce Foam in 2005 and International Foam Technologies Spain S.L. in 2019. Both the entities are profit making with an EBITDA margin of 9.3% and 10.9%, respectively, in FY23. Moreover, SFL has always maintained strong financial discipline while being involved in acquisitions. Ind-Ra takes comfort from the company's ability to generate returns out of acquired entities.

Threat from Organised Home Decor Outlets and Increasing Online Share: Ind-Ra believes the launch of organised home decor outlets could disrupt SFL's sales channel since the company largely sells offline. However, the same would be mitigated, to some extent, through SFL's investment in Furlenco where SFL will have the cross-selling opportunity to showcase its products in Furlenco's stores as well as on its digital platform.

Exposure to Cyclicality and Economic Downturns: SFL's major revenue generating segment is its home comfort line (74% of FY23 revenue), which primarily includes mattresses, pillows and cushions. Since these are discretionary products, they remain exposed to the economic downturn of the economy and highly depend on the purchasing power of its consumers. Furthermore, the business is cyclical with the peak sales being generated over October-January. Hence, any impact on the gross domestic product leading to decreased purchasing power of the customers or a change in customer preferences might impact SFL's topline.

Susceptibility to Volatility in Raw Materials; Forex Risk: SFL's major raw materials include polyol and TDI (toluene diisocyanate), which account for 60%-70% of the total manufacturing cost. These raw materials are manufactured from the by-products of crude oil, and hence, any movement in crude oil prices might impact the price of these raw materials, thus impacting SFL's EBITDA margins; however, there are other factors too, including supply chain issues, which impact the prices. While the company is able to pass on the price hikes to its customers, thereby mitigating input price volatility partially, the same remains subject to competitive pressures. Furthermore, 25%-30% of the total raw material requirement is imported, exposing the company to fluctuations in forex rates.

Standalone Financials: SFL reported a revenue of INR20,198 million in FY23 (FY22: INR20,082 million; FY21: INR16,895 million), EBITDA of INR2,222 million (INR2,338 million; INR2,329 million), interest coverage of 34.9x (32.9x; 26.8x) and net cash in FY21-FY23.

Rating Sensitivities

Positive: A significant improvement in the revenue as well as profitability while keeping the net leverage below 1.0x could be positive for the ratings.

Negative: Developments that could, individually or collectively, lead to a negative rating action include:

- a decline in the revenue and profitability or an elongation of the net working capital cycle on a sustained basis
- any significant debt-funded acquisition, leading to the consolidated net leverage exceeding 1.5x beyond FY24 on a sustained basis

Company Profile

SFL, established in 1971, is a leading manufacturer of PU foams in Asia Pacific. The company has secured a dominant position in key industries such as mattresses, automotive, footwear, lingerie, and furniture. The Company specialises in the production of a diverse range of foam-based home comfort products, such as mattresses and furniture cushions. SFL operates in flagship brands, including Sleepwell for mattresses and home comfort, Feather Foam for pure PU foam, and Lamiflex for polyester foam used in lamination. The company has a global reach, with 11 manufacturing plants nationwide in India, five in Australia, and one in Spain.

CONSOLIDATED FINANCIAL SUMMARY

Particulars	FY23	FY22
Revenue (INR million)	28,733	28,656
EBITDA (INR million)	2,973	3,149
EBITDA Margin (%)	10.3	11.0
Interest Coverage (x)	14.1	18.6
Net Leverage (x)	Net Cash	1.1
Source: SFL, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

Complexity Level of Instruments

Not applicable

Contact

Primary Analyst
Shefali Joshi
Senior Analyst
India Ratings and Research Pvt Ltd
DLF Epitome, Level 16, Building No. 5, Tower B DLF Cyber City, Gurugram Haryana - 122002

For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst
Shruti Saboo
Director
0124 6687265

Chairperson
Vivek Jain
Director
+91 124 6687249

Media Relation
Ameya Bodkhe
Marketing Manager
+91 22 40356121

APPLICABLE CRITERIA

Evaluating Corporate Governance

Corporate Rating Methodology

The Rating Process

DISCLAIMER