



## “Sheela Foam Limited Q3 FY2018 Earnings Conference Call”

February 06, 2018



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**Moderator:** Ladies and gentlemen, good day and welcome to Sheela Foam Limited Q3 FY2018 Earnings Conference Call, hosted by ICICI Securities. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “\*” then “0” on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Gaurav Jogani from ICICI Securities. Thank you and over to you Sir!

**Gaurav Jogani:** Good morning. I welcome you to the Sheela Foams Q3 FY2018 concall. We have with us Mr. Rahul Gautam, Managing Director and Mr. Dhruv Mathur, CFO from Sheela Foam. Over to you Sir!

**Rahul Gautam:** Gaurav, thank you very much for introducing us, although we were not on line for that small little time, so I hope that you have introduced as well. I just want to begin by saying good morning to the ladies and gentlemen who have joined in. This is Rahul Gautam. I have with me Mr. D. C. Mathur, our CFO and Tushaar Gautam, who is Director and we are here presenting the Sheela Foam results for Q3 of FY2018. I want to begin by saying that the volatile and uncertain times kind of continue because all the major changes that have taken place are taking their own time to settle down and the government is trying its best; however, these things are probably bigger than what one can ever kind of plan. GST continues to be the flavour of the economy and flavour for our industry, some good things have happened that on our mattresses, the rate has come down from 28% to 18%, what this does is that it reduces the gap between people who are and who are not in the formal part of the business and therefore it is helpful. We had the advantage for about half the quarter, which has gone by, but now it is well established. Our belief is that 18% is a tax rate, which should be pretty stable for all times to come, there may only be a shift of 1% or 2% here or there.

The other thing on the GST part, which we were waiting for eagerly was the E-way bill, which takes the time dependence of delivery of material and people who may want to sort of fool around with that. Unfortunately it did come on the February 1, but because of some technical glitches has fallen back, but we hope that it begins very, very quickly and the other big huge thing which has been continuing in our business is the TDI prices, which has been high and slightly increasing, we were expecting that this quarter at least or middle of last quarter, the prices should have started to fall down, they did drop for a while, but they have again kind of climbed back.

The good news is that Sadara, which is the largest facility created for manufacturing of TDI, although delayed a bit, but has started and we have received the first lot from them and the quality and everything is all good and sound. The results that you would have seen were stable. There has not been much of growth, but that is primarily because of these conditions, which have been existing. The company is even accepting that the TDI is going to be on a high level, is intending to combat this by looking at or reviewing all the products and all the foams, so that without sacrificing or actually kind of increasing the benefits to the consumers how we can reduce the impact of these all volatile fluctuations in the raw material side and as everybody knows that necessity is the mother of inventions and we have found some ways and as we go, along we will find more and more ways of – so actually I am at a bit of loss where the line got disconnected; however, I will continue and sorry for this disruption, I do not know, it appears like a technical flaw somewhere that it has taken place, so I was talking about our low-end product Starlite, which after all the piloting and the feedback from the market has been reconfigured and has been repositioned and now it has been open to all the zones and all parts, results are extremely positive and extremely encouraging and from here on, we should be seeing a full kind of a growth on that.

The other foray that we have been doing is the furniture side of the business where we have got the two main people who are responsible for consumption of cushions, one is the influencer, which is the carpenters or the karigars as we say and we have a programme running for them, it is called the saathi programme and they will help in selling Sleepwell and feather foam cushions.

The other area that we are targeting is smaller companies and factories, which manufacture furniture and which have been till now not connected up with us, so we are approaching them to partner with us in this journey and we would have a programme similar to Intel Inside, where we would say Sleepwell inside and that tag can go along with a furniture manufacturers products giving assurance to the consumer. So generally the timber and the furnishing was the focus of the consumer while the functional part, which was the polyurethane foam or good quality polyurethane foam was not remembered or not looked into. Now this programme will ensure that furniture, which is the second largest industry for us, we will grow in that area. We have recently had the budget and all I can say is it has all the right focus areas like the rural or the agricultural side, infrastructure side and of course the social side, which is the National Health Protection Scheme. Our industry would definitely benefit out of this because we are connected with at least the two sides of it, which is rural side as well as the social, the health side of it, so I see that as we kind of go along all the...let me not call them as disruptions, but the big changes that have happened

including GST slowly beginning to settle down, the market is beginning to settle down and the consumer is coming back into the markets to buy and therefore starting from the quarter that has began, the quarter that we are in the middle of, we should see good signs as we look forward. So, I just want to thank you and we would now be open for questions.

- Moderator:** Thank you very much Sir. Ladies and gentlemen we will now begin with the question and answer session. Ladies and gentlemen we will wait for a moment while the question queue assembles. We will take the first question from the line of Nihal Jham from Edelweiss. Please go ahead.
- Nihal Jham:** Good morning to the entire management. First question is that could you give us the breakup between price mix and volume growth for this quarter?
- Dhruv C. Mathur:** Primarily this has been a growth on price only, there is not much growth on volume, almost same as it was in the corresponding quarter of last year though volume in terms of trailing quarter has gone up, but Q-on-Q FY2017, they are constant.
- Nihal Jham:** Last quarter we had a volume growth of 5%; I am guessing that this quarter you are seeing it is more or less close to flat volume growth right?
- Dhruv C. Mathur:** That is right.
- Nihal Jham:** Sir I am guessing that would you call this mainly related to the disruption, which has happened because maybe we had a phase of demonetisation, which did impact our business in the same quarter last year?
- Rahul Gautam:** If you recall up to November 8, we had record sales and it has something to do with Diwali also this can be a bit earlier, so that is why you saw the growth in the second quarter and as far as the demonetisation impact, we have been saying that to us demonetisation had very little impact in that particular quarter and our sales were like 78%, 80% of normal sales, but the past 40 days were extraordinary, so I think that gives some kind of semblance.
- Nihal Jham:** Absolutely, so going ahead what is the kind of volume growth that we can expect; do we expect that Q4 be expected to be normal?
- Rahul Gautam:** Yes Q4 is expected to be normal absolutely.
- Nihal Jham:** Generally in the long run what is the kind of volume growth you expect considering the E-way bill and all the other factors that are positive for the sector in general?

- Rahul Gautam:** So I can guess for a very long time or a little longish time because that is where all these kind of stability will come in, so I would say that the volume growth should be about 7%, 8% and price of about 4%, 5%, so totalling to about 13%, 14% is what we look forward to.
- Nihal Jham:** So just one last question on Starlite, I wanted to understand what is the kind of feedback you have received from the market and you mentioned about repositioning at all, so just if you could give a little more detail on that?
- Rahul Gautam:** Sorry if I use the word repositioning, the position is absolutely fine, it was just on the product we are introduced two models for the product and one of the model was not preferred and needed a bit of tweaking up that was the feedback and that has been done and this is thereon.
- Nihal Jham:** How has the performance of that product been, any numbers to share on that?
- Rahul Gautam:** I would say that last quarters, how many?
- Dhruv C. Mathur:** Last quarter, these are only in the north and the number was around 15,000.
- Nihal Jham:** 15,000 mattresses.
- Dhruv C. Mathur:** That is right.
- Nihal Jham:** Price point in this category is around 3000 to 5000, what is the lowest range mattress that we have in Starlite?
- Rahul Gautam:** The Starlite is pretty close to about Rs.5000 a pair.
- Nihal Jham:** I guess the similar competitor in the unorganized space would come to around 3,500 to 4000?
- Rahul Gautam:** That is right, sometimes this comparison gets a little bit tough because what is inside the mattress people do not know, but yes you are right that the unorganized sector would be about 3, 3.5, so as I said because of this change in the GST rate this 3.5 would have become like 4, 4.5, or 4.25 because the difference would have decreased.
- Nihal Jham:** Fair enough. Sure Sir. I will get back in the queue for more question. Thank you so much.

- Moderator:** Thank you. We will take the next question from the line of Parthiv Jhonsa from NVS Brokerage. Please go ahead.
- Parthiv Jhonsa:** Good morning Sir. I have got a couple of questions actually. First I would like to understand the furniture business, which we are into, so what would be the percentage of furniture business as a part of the total revenue and the profitability?
- Dhruv C. Mathur:** Furniture business is close to 20% of our business.
- Parthiv Jhonsa:** What about - going forward do we expect it to grow as a percentage of topline and profitability?
- Dhruv C. Mathur:** There might be a shift from foam core business to furniture business.
- Parthiv Jhonsa:** Okay, because all the big companies like IKEA are rolling in the market, so that can be added advantage to you?
- Rahul Gautam:** Correct, historically furniture business or the furniture industry was completely controlled by the government, so there was no organized sector, which was allowed to put it in fact, it was reserved for the cottage industry that is why it is a very fragmented industry. Now we are trying to put that together and saying that whatever furniture you make, please ensure that the functional part ,important part- which is the polyurethane in fact should be sourced from us, from Sleepwell.
- Parthiv Jhonsa:** Okay, got it and second question is on the raw material, the TDI basically, the prices have gone up in the last couple of months, how do you look going forward, how does it look?
- Rahul Gautam:** I have probably bitten my tongue many times, but as we all know that these are commodities and they do follow a cycle, sometimes very difficult to predict, but all indicators for the last couple of months have been that the price just needs to come down, but somewhere one or two plants across the world do experience for completely unconnected reasons, some force majeure conditions but as we look forward, it has to be going down and then stabilizing. It cannot exist at this level forever, it just cannot.
- Parthiv Jhonsa:** So you expect from Q1 going to stabilize or from Q4 itself?
- Rahul Gautam:** I expect it more from Q1. Because we already, the largest plant as I said we have got the first consignment. Technically the product is absolutely fine. Commercially, they have now

started ramping up their production I think globally the impact happening it does take a couple of months before you can see all these softening begin to happen.

**Parthiv Jhonsa:** And last question is a little bit on the subjective end, so can I just have idea on what would be the market size of Sheela Foam compared to all the organized players?

**Rahul Gautam:** We had said that that on the mattress side, the modern mattresses constitute about Rs.1 0000 Crores and out of that the organized sector is about Rs3500 Crores and we are about 23% of that.

**Parthiv Jhonsa:** Okay, so 20% to 23% of that and we have seen that has been your historical record right, because in the presentation also had mentioned the same market share?

**Rahul Gautam:** Correct, in fact that is based on the research done at that time, I think if we did a modern research or new research we would find that this number should have gone up, but for the lack of any valid, there is no number crunching that happens in our industry, but we can feel that shift happening in the market.

**Parthiv Jhonsa:** Okay, are you planning to come out with something like the economic mattress, which you launched sometime last year, so something like that great news anything expected in the coming months?

**Rahul Gautam:** We have already launched that and that is now ramping up, it is gone through all...

**Parthiv Jhonsa:** Apart from that anything new, are you planning on the product side?

**Rahul Gautam:** So there is a demand for a mattress, which I would call it, a full foam mattress and we are planning that, but it is still in a bit of a planning at this stage I cannot say anything more on this.

**Parthiv Jhonsa:** Okay, Sir I will back in the queue.

**Moderator:** Thank you. We will take the next question from the line of Ravi Naredi from Naredi Investments. Please go ahead.

**Ravi Naredi:** How much percentage sales of technical product in our overall sale Sir today in this quarter?

**Rahul Gautam:** It is 19%.

- Ravi Naredi:** 19% and are you hoping, it will raise more compared to mattress business in future?
- Dhruv C. Mathur:** We have the thinking of both the business going up, so it is difficult to say whether the percentage of technical foam will go up in the overall business.
- Rahul Gautam:** It may just change 1%.
- Dhruv C. Mathur:** 1% share of, it keeps on fluctuating between 18% to 20%.
- Ravi Naredi:** Are we selling it to our furniture dealer or the products are selling through other dealing network?
- Dhruv C. Mathur:** Technical foam is not that category, furniture foam is in our B2C business, which is sold through channel .As I have just answered technical business, is around 20% in our total sales. This technical foam is the form, which we sell to different industries like automobile, shoe, longeries, and generator etc. that is the technical foam.
- Ravi Naredi:** Thank you very much Sir.
- Moderator:** Thank you. We will take the followup question from the line of Parthiv Jhonsa from NVS Brokerage. Please go ahead.
- Parthiv Jhonsa:** Just to go on the mattress side, we have basically moved into the foams, the foam mattresses. So there are other kinds of mattresses like the coir mattresses, are we planning to expand in that front as well?
- Dhruv C. Mathur:** Currently we make all kinds of mattresses, we make foam mattresses, spring mattresses, coir mattresses everything and foam is an integral part of all mattresses including coir mattresses. As I said that the coir mattress is also part of our repertoire but as times are going forward coir, which used to enjoy certain protection of duties and taxes, the last differential has gone on November 15, where the GST rate for it was 18% ,foam and spring mattresses at 28%, all that has been brought down to 18%. So with that differential going away, I do not see to bright future for coir itself. Though it may still constitute a little part of some of the mattresses. Therefore any kind of a special initiative from our side for coir is not coming forth.
- Parthiv Jhonsa:** Okay and are we planning any capex going forward?



- Dhruv C. Mathur:** We have a maintenance capex around Rs.40 Crores to Rs.50 Crores every year, we had thought of two plants and which will entail the investment of around Rs.50 Crores for each plant, we are yet to identify the location etc, so this is broad plan on capex.
- Parthiv Jhonsa:** Okay, thank you so much Sir.
- Moderator:** Thank you. We will take the next question from the line of Gaurav Jogani from ICICI Securities. Please go ahead.
- Gaurav Jogani:** Thank you for giving me the opportunity Sir. What would be the average TDI price for this particular Q3 FY2018?
- Dhruv C. Mathur:** To us the average price has been Rs.293 to the company.
- Gaurav Jogani:** Okay and as you said that the Sadara facility has been starting production and I think globally also there were few facilities in Germany and other places that were closed due to force majeure and I think they are expected to come on line by Q1 of FY2019. So is that expected to break down the prices down materially for TDI going ahead?
- Dhruv C. Mathur:** We have been expecting that for long time. Unfortunately even in this quarter, there was some global problem and even in India the biggest plant of GNFC Dahej had gas leakage because of this, there was disruption in supply and that also caused further increase in the price, so our expectations are there like that from Q1 the prices may go down when the capacities are functional.
- Gaurav Jogani:** And Sir one more thing in terms of like if you see if we ignored the gross margin part which was effected due to the increase in the raw material prices, I think we have done a quite good bit of cost saving measures which has helped more or less to protect our EBITDA margin? So are these initiatives sustainable and can we see a larger EBITDA margin expansion once the TDI prices come down going ahead.
- Dhruv C. Mathur:** We nearly hope so once that happens then all other steps ,all other things are in place. Our yields are improving; everything is going in the right direction.
- Gaurav Jogani:** Thank you so much Sir. That is all from my end.
- Moderator:** Thank you. We will take the next question from the line of Ashish Kacholia from Lucky Investment Managers. Please go ahead.

- Ashish Kacholia:** Good morning Sir. My question pertains to the kind of volume growth we found in this quarter. What is the volume growth that we had in this quarter, Y-o-Y?
- Dhruv C. Mathur:** We did not have much volume growth in this quarter; it was quite flat whatever growth has come around 8% it is because of the prices.
- Ashish Kacholia:** Since this was a DeMon quarter last year and we have had no volume growth in this quarter versus that quarter does it worry you?
- Dhruv C. Mathur:** No it does not worry us because we are in this industry and we realize that this year Diwali was much earlier, so Diwali volume growth in the previous quarter. So this is seasonal thing that it is flat and also because of DeMon, we were not impacted much we have been stating this in our road shows also, it did not impact us of much at that time.
- Ashish Kacholia:** DeMon did not affect us much at that time?
- Dhruv C. Mathur:** That is right.
- Ashish Kacholia:** Okay and what is the volume trend looking for January, February whatever we have seen in this, are we coming back on the volume growth front?
- Dhruv C. Mathur:** Yes, it appears that there would be volume growth in this quarter vis-à-vis the corresponding quarter, last year.
- Ashish Kacholia:** Okay, what kind of volume growth can we expect in the medium term?
- Dhruv C. Mathur:** In the medium terms, we are expecting 7% to 8% and of course we had stated in announcement, it should be still higher.
- Ashish Kacholia:** Okay and this given the side that India is under-penetrated market that and so on but is there no way this volume growth can move into double digit?
- Dhruv C. Mathur:** We are doing all that to achieve this kind of target and we also have this on our radar.
- Rahul Gautam:** I think as soon as the GST completely plays itself out which is from the concepts to the implementation to one rates to, we are taking care of all the people who are trying to evade and avoid is really the big shift when it will come from the unorganized to the organized and then for sure there will be improvement.

- Ashish Kacholia:** Okay, what is the typical lead distance of the distance that our mattress has for us?
- Rahul Gautam:** Sorry I did not get the question.
- Ashish Kacholia:** From the factory to the retailer, what is the kind of distance that our mattress travels, it is the volume at a time that I am asking this question Sir?
- Dhruv C. Mathur:** Are you taking of physical distance?
- Ashish Kacholia:** Physical distance from the plant to the retailer?
- Rahul Gautam:** I mean the shortest distance is about 20km, but the highest distance can be about 450km.
- Ashish Kacholia:** Would we have any sense of the average lead like in the cement factory they always say that we have average lead of 200km or 250 whatever it is in the cement industry, could you have similar lead for our mattress average lead?
- Rahul Gautam:** No, we do not, Ashish but let me just say that beyond the factories there are also these 110 exclusive distributors which are stocking points and the distance is only from there to the retailer which is not much.
- Ashish Kacholia:** We were to understand from our factory to the distributor, this is the easiest metrics I am just saying. I am asking whether this E-way bill will really make a difference, because if the mattress just travel long distance, the trucker is more at risk of being caught on an interstate point or something. If it is going to be small distances then you just has to manage the local cop and he would pretty much continue and this is the way he has been doing, so that is my line in questioning.
- Rahul Gautam:** Now I get it. You probably are keeping the concept of E-way bill and all those things in mind
- Ashish Kacholia:** Everybody is hoping that the e-way bill will kind of force trucking industry not to carry tax unpaid stuff, but if the lead distance is small say 50km or if it does not really cross too many state boundaries or where the checking is likely to little more stringent, so that is my line of bringing, so we may all be hoping and it may never, our hope may not come true.
- Rahul Gautam:** Sorry but I am looking it in a little different manner which is to say that I hope that all these checking and all these kinds of happen as far as we are concerned we would be more than happy if something is sort of checked on the way and found to be okay and it kind of

continues and for the unorganized sector that it may become a bit of a difficulty that should give you a good legal edge which should happen, but for as we are not concerned on that at all, it is not a worry that what is the distance except for the time that it will take for the delivery.

**Ashish Kacholia:** And given the fact that it is still a very under-penetrated market, do not you think we should be going at a 20% kind of volume growth rate or otherwise premise of this being under penetrated market kind of falls flat?

**Rahul Gautam:** You are quite right, it will happen as I said that all these disruptions or all these big changes, we just need to kind of settle down. If it becomes a little bit normalcy kind, it will grow that that is exactly the potential that that is there.

**Ashish Kacholia:** And what is the GST rate that is there on our product Sir?

**Rahul Gautam:** Sorry.

**Ashish Kacholia:** What is the GST rate that is imposed on mattresses?

**Rahul Gautam:** 18%.

**Ashish Kacholia:** Alright. All the very best Sir. Thank you very much.

**Moderator:** Thank you. We will take the next question from the line of Nihal Jham from Edelweiss. Please go ahead.

**Nihal Jham:** Just taking the point on GST forward, it has been six months since GST as we implemented, so what are the kind of saving that we are seeing post the implementation and what are the benefits or say the disadvantages we have come across?

**Dhruv C. Mathur:** As we have been saying that it has been implemented but the government, the network everything is very slow on this. So organized sector is fully compliant with everything; however, the filing of each invoices on the system could start only in January, so the regulatory things are still lagging behind, so the real impact of GST is not to be seen by anybody. What we can say is the small negative impact on us was on the account of refund from our exempted unit where we are getting only 58% refund instead of 100% in exempted unit. Barring that we are not seeing big movement from unorganized to organized just because the regulatory things are not in place at this moment. Our hope is that once if every

invoice is tracked down, E-way bill is started then there is a real pressure on the unorganized sector to fully comply, then you can see the shift which all of us are expecting.

**Nihal Jham:** And has there been any benefit on our cost reducing because of getting now that pass through is a little bit..?

**Dhruv C. Mathur:** We have done that only it is because of those actions, which have taken like improvement on yield etc despite not increasing the prices to the level it should have been increased due to raw material price increase. We have been able to maintain our EBITDA margins with 11.5% on consol basis.

**Nihal Jham:** Absolutely, so is it possible that you had to say 1% improvement in your margins because of GST any possibilities to quantify that?

**Dhruv C. Mathur:** That is not correct. It has not happened like that. Our expectation is not and we never thought that we would kind of make money out of change in GST rate or something. For example, when the rate went down from 28% to 18% next day we reduced the prices and advertised that thing itself. So we do not see benefit in terms of pricing, but the volume growth, which we are looking.

**Nihal Jham:** Just one last part I think we have around network of 5000 dealers that we were looking at lastly, how is the growth in that being till date?

**Dhruv C. Mathur:** It is more than 6000 dealers at this moment.

**Nihal Jham:** Okay, we have added 1000 dealers over the last one-year is what would be the right way to tell. Thank you so much.

**Moderator:** Thank you. We will take the next question from the line of Parthiv Jhonsa from NVS Brokerage. Please go ahead.

**Parthiv Jhonsa:** I just wanted to understand before November what was the GST rate for the mattresses?

**Rahul Gautam:** For the mattresses it was 28%; however, for coir mattresses it was 18%.

**Parthiv Jhonsa:** Okay and so now all the mattress is on par at 18%?

**Rahul Gautam:** That is right.

- Parthiv Jhonsa:** So for the first couple of months, I just wanted to understand the GST working, so do you get the refund for that about 10% what you have paid for those two to three months or is it 28% and then it is our 18%?
- Rahul Gautam:** It became effective from November 15, so whatever invoicing was happening from our end was 18% instead of 28%.
- Parthiv Jhonsa:** The previous 28% do you get refund, the 10% that you have paid over and above 18% or it is totally different?
- Rahul Gautam:** If it was sold to the consumer, it is already paid, it is already sold and the tax collected and deposited; however, if we had paid and our channel as taken can credit for it that credit is neutralizable for the future sales of 18% in any case. So there is no money, which is lost, but the money is there. The only thing is the consumer who is already bought it at 28% then that will be end of the story.
- Parthiv Jhonsa:** So that is the end of the story and money was tied up already there.
- Rahul Gautam:** But if it is in the channel then the channel gets that 28% which we may have discharged as a credit and it is paying 18% so it may take a little longer time for all that to go away, but there is no money which is lost.
- Parthiv Jhonsa:** Okay, got it Sir. Thank you.
- Moderator:** Thank you. We will take the next question from the line of Gaurav Jogani from ICICI Securities. Please go ahead.
- Gaurav Jogani:** Sir I wanted to know have we did any terms of agreements like with the dealer or the distributor level I mean any discounts or promotions have been reduced during the quarter?
- Dhruv C. Mathur:** No, we did not.
- Gaurav Jogani:** Okay, that is it from my end Sir. Thank you.
- Moderator:** Thank you. As there are no further questions from the participants I would now like to hand the conference over to the management for closing comments.
- Dhruv C. Mathur:** Ladies and gentlemen thank you very much for the questions and they were all extremely relevant and though they are also part of our concern as we kind of go forward, but that said



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the expense of even repeating myself I say that we look forwards to the coming time is extremely interesting and far more stable than what has happened in the past. The budget, which the Government of India has presented, also does not have any huge disruptions so to say, so I look forward to interesting times and look forward to catching up with you as soon as our year finishes and that we will be reporting the annual results. So thank you very much and thanks to ICICI Securities for hosting this call. Thank you.

**Moderator:**

Thank you very much Sir. Ladies and gentlemen on behalf of ICICI Securities that concludes this conference. Thank you for joining you. You may now disconnect your lines.