ICICI direct Research

March 2, 2022

Nano Nivesh

Faze Three (FAZTHR)

Buy Price: ₹ 290 | Fair Value: ₹ 385 | Potential Upside: 33% | Recommendation: BUY

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Niche play on home textile exports…

About the stock: Through its differentiated product offerings and business model, Faze Three (FTL) stands apart from other home textile players. It manufactures and exports multiple home textile product categories (apart from bed sheets, towels that currently other listed players specialise in) with bathmats & rugs being the dominant category (~80% of revenues).

- US, UK/Europe regions contribute ~90% of its overall revenues. Top 15 customers comprise very large retail chains such as Walmart & Target
- Vertically integrated business model with in-house capability of design & development. FTL's order book is mostly backed by customer commitments

9MFY22 Performance: For YTDFY22, it displayed a superior performance.

- Revenue grew robustly by 60% YoY largely driven by volume growth
- EBITDA margins improved significantly by 120 bps YoY to 16.2%
- PAT grew 2x YoY to ₹ 35.3 crore (PAT margin: 10.2%)

What should investors do? Over the past five years, the impact of FTL's improved financial performance has been visible in upward momentum in stock price, which has grown at ~19% CAGR over the period.

- We initiate coverage under I-Direct Nano format with a **BUY** rating

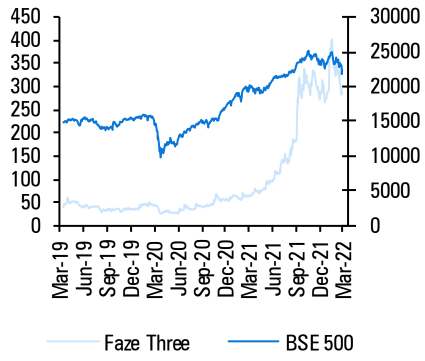
Target Price and Valuation: We value Faze Three at ₹ 385 i.e. 13x FY24E EPS of ₹ 30

Key triggers for future price performance:

- It is currently operating at peak utilisation levels and has a healthy order book for the next two quarters
- Embarked on brownfield capex and outlined capex of ₹ 80 crore across product lines, categories like rugs, bathmats and top of the bed segments
- The aforesaid capex expected to generate incremental revenue worth ~₹ 800-1000 crore (asset turnover: 8-10x). Value accretive capital deployment to enhance RoCE to 25%+ in the next three to four years
- Visible shift by large retailers of sourcing to India from China across the company's product categories to create sustained demand
- We build in revenue, earnings CAGR of 27%, 41%, respectively, in FY21-24E

Nano Nivesh

Price Performance



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ICICI Securities – Retail Equity Research

Key Financial Summary

Financials	FY19	FY20	FY21	5 Year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 Year CAGR (FY21-24E)
Net Sales	268.6	302.2	324.2	6.1%	480.0	561.6	662.7	26.9%
EBITDA	28.0	34.8	47.8	11.0%	77.8	87.6	106.7	30.7%
EBITDA Margin (%)	10.4	11.5	14.7		16.2	15.6	16.1	
Net Profit	15.1	19.3	25.0		47.9	57.0	72.0	42.2%
EPS (₹)	6.2	7.9	10.3		19.7	23.4	29.6	
P/E (x)	46.9	36.6	28.2		14.7	12.4	9.8	
EV/EBITDA (x)	27.0	21.4	15.8		10.3	8.9	7.0	
RoCE (%)	9.7	12.1	12.9		18.3	18.7	20.6	
RoE (%)	8.1	9.6	11.1		17.5	17.2	17.9	

Source: Company, ICICI Direct Research

Description

Founded in 1985, Faze Three is a niche player focusing on manufacturing home textiles products. The company has a diversified product portfolio that consists of bathmats, rugs (rubber backed), performance and outdoor home textiles, cushions, top of the bed products, blankets and accessories. The company directly exports its product to the US, UK and European region and exports constitute ~90% of its revenues with the US contributing ~60% while UK/Europe contribute 30% of export revenues. The company has strong manufacturing capabilities with seven factories serving the needs of various clients. The key differentiating factor of the company compared to peers is that it has an in-house design and product development capability and fast order turnaround time, which enables it to get repeat orders from existing clients and pursue newer clients. Also, the company's comprehensive product portfolio makes it the preferred vendor for global retailers to source multiple home textile product requirements from the company rather than placing orders for specific products with different suppliers.

History and track record

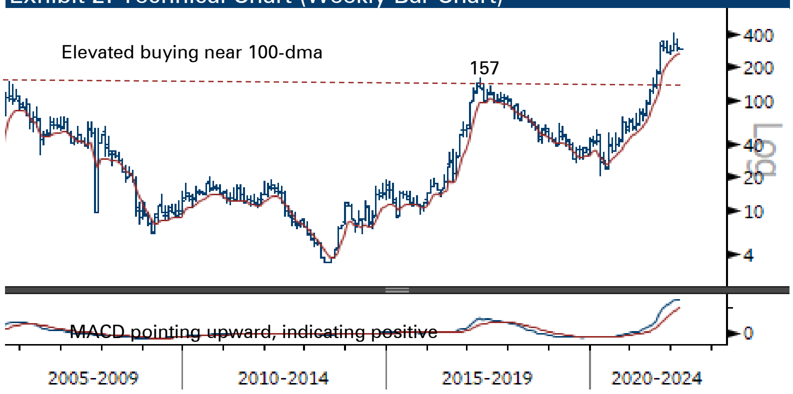
- **1985**: FTL started its operations in 1985 and has transitioned from a trader of home textile products to a company with manufacturing capability across Home Textiles products
- **1992-2003**: During the period, the company expanded its manufacturing infrastructure by setting up seven state of the art plants at Silvassa, Panipat (four handloom units) and Vapi
- **2017-23**: FTL invested over ₹ 40 crore (FY17-20) from internal accruals across units for installing new machinery & de-bottlenecking. It is further planning a capex of ₹ 80 crore to augment its production capacities by 2.5x-3x by FY23
- **Esteemed client base:** The company serves the needs of large global clients such as Walmart, Target, Macy's from US and Sainsbury, ASDA, and Marks & Spencer from UK/Europe

Exhibit 1: Earnings Estimates

₹ crore	FY20	FY21	FY22E	FY23E	FY24E
Sales	302.2	324.2	480.0	561.6	662.7
EBITDA	34.8	47.8	77.8	87.6	106.7
EBITDA (%)	11.5	14.7	16.2	15.6	16.1
PAT	19.3	25.0	47.9	57.0	72.0
EPS	7.9	10.3	19.7	23.4	29.6

Source: Company, ICICI Direct Research

Exhibit 2: Technical Chart (Weekly Bar Chart)



Source: Bloomberg, ICICI Direct Research

Stock data

Particulars	Amount
Market Capitalisation (₹ crore)	705.3
Total Debt (FY21) (₹ crore)	91.6
Cash (FY21) (₹ crore)	42.5
EV (₹ crore)	754.5
52 Week H / L	413 /61
Equity Capital (₹ crore)	24.3
Face Value (₹)	10.0

Valuation

	FY21	FY22E	FY23E	FY24E
P/E	28.2	14.7	12.4	9.8
EV / EBITDA	15.8	10.3	8.9	7.0
EV / Sales	2.3	1.7	1.4	1.1
Price to Book Value	3.1	2.6	2.1	1.7
RoCE	12.9	18.3	18.7	20.6
RoE	11.1	17.5	17.2	17.9

Quarterly performance

	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Sales	109.0	100.0	117.0	132.0
EBITDA	15.0	13.0	21.0	23.0
EBITDA (%)	13.8	13.0	17.9	17.4
Other Income	1.0	3.0	2.0	1.0
PAT	8.6	9.0	13.6	12.7
EPS	3.6	3.7	5.6	5.2

Shareholding trend (%)

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Promoter	49.3	49.5	49.5	50.3	51.3
FII	4.5	4.5	2.5	-	-
DII	-	-	-	-	-
Others	46.2	46.0	48.0	49.7	48.7

Technical View

The share price recorded a strong breakout from a multi-year consolidation phase (2005-20) in CY21 indicating a structural turnaround from a long term perspective.

The key observation in the entire rally from CY20 lows has been that stock price has consistently attracted elevated buying demand in the vicinity of 100-day EMA indicating robust price structure.

At the current juncture, the stock price has corrected from its lifetime high of ₹ 413 and is currently hovering around 100-day EMA around ₹ 280.

Structurally, shallow pace of retracement of preceding strong rally indicates inherent strength in the stock.

What's the story?

Rising Phoenix from the ashes…

The company, over the last few years, has successfully scripted a turnaround with material improvement in financial performance and leverage ratios. For Faze Three, FY13-17 was the most challenging phase as its wholly owned German subsidiary (Pana Textile) had to undergo insolvency and it faced increased payment obligation towards FCCB debentures. The same had translated into long term liabilities worth ₹ 140 crore, which had put a significant burden on the company's balance sheet. During the aforesaid period, revenue grew moderately (CAGR: ~6%) owing to constrained working capital availability. With fresh capital infusion from investors and promoters in FY17, the company's capital structure improved materially with repayment of long term liabilities and net worth turning positive. Post this, the company made investments in designs & developments, key human resources, plants, supply value chain, etc. Also, FTL realigned its product mix and customer mix to make it more favourable. The efforts undertaken by the management were visible with improvement in capacity utilisation rates (from ~40% in FY13 to 65% in FY21) and enhanced margin profile (from 8% in FY14 to 15% in FY21).

China + 1, increased prevalence of work from home across globe accentuated growth in FY22

The company's financial performance has already been on an uptrend since FY18 onwards. However, China+ 1 strategy adopted by global retailers and increased work from home practice adopted by major companies globally has further accentuated the demand for products of FTL in FY22E. The company's utilisation rates got enhanced significantly from 65% to ~95% in FY22E. The company indicated there was huge unfulfilled demand within the existing customer base and it could not service the same owing to capacity constraints. Revenue grew 60% YoY in 9MFY22 to ₹ 350 crore with average quarterly revenues increasing to ~₹ 115 crore vs. ₹ 75 crore. EBITDA margins improved further by 120 bps YoY to 16.2% (one of its highest margins). The EBITDA margin of the company would have been 20%+ in FY22E, if not for higher operating cost (power, logistics) and lower incentive rates (RoDTEP). While demand for its core product portfolio (bathmats & rugs) remained heathy, robust demand was also witnessed in top of the bed product categories and allied home textile products. The company has a strong order book for the next six months and is expected to take judicious price hikes owing to RM cost inflation. FTL generally fixes the pricing of its products on a cost plus basis for each batch of orders and, hence, does not visualise significant negative impact on margins owing to the input cost inflation.

Embarking on brownfield capex to service new orders and capture larger pie in global market

In a bid to capture long term growth opportunities the company has embarked on brownfield capacity expansion and outlined capex worth ₹ 80 crore, which will be funded mainly through internal accruals. Out of total capex, ~38% (₹ 30 crore) is spent towards expansion in Silvassa Plant under floor covering segment (2.5x capacity enhancement by March 2022). Also, it commenced expansion in its handloom home textile division in Panipat (~₹ 35 crore), which would enhance capacity by 3x by April 2023. The remaining capex amount is to be spent towards enhancing top of the bed & blanket segment by 3x of existing capacity and is backed by commitments from various clientele. With a targeted asset turnover of ~8-10x of new capex, the company has chalked out a plan to build FTL's revenue to ₹ 1500 crore in the next five to six years (from current ~₹ 480 crore). We expect flooring segment (bathmats & rugs) to contribute ~70% of revenues while top of the bed and other allied segment are expected to contribute ~30% (from existing 15%). We expect healthy order inflows, going ahead, given the nature of the business where clients tend to be sticky and its niche positioning amongst top retailers in its product lines and timely execution. Designing capability and efficient turnaround cycle (90-120 days) are key competitive advantages for the company compared to its smaller peers. Most of the competition in handloom is from unorganised players who usually do not adhere to compliance standards required by large brands. Hence, the company's factory being compliant as per global standards has a competitive advantage as global brands are likely to place orders with compliant facilities.

Capital deployment towards value accretive projects to improve return ratios; assign BUY rating

Backed by a healthy order book and capacity augmentation, we build in revenue CAGR of 27% in FY21-24E. We expect the company to maintain current PAT margin levels of 10-11% in FY22-24E. This would translate into earnings CAGR of 41% in FY21-24E. Higher working capital requirements (owing to container shortages) and capex may result in short term debt increasing to ₹ 130 crore (D/E: 0.5x) in FY22E. However, with steady FCF generation, going forward, we expect D/E ratio to decline to 0.2x by FY24E. Capital deployment towards value accretive projects to generate incremental RoCE of 25%+. Hence, we expect RoIC to improve from 15% in FY21 to 23% in FY24E. Healthy earnings momentum, comfortable debt equity ratio and sustained improvement in RoICs (in excess of 20%) will trigger a re-rating of valuation multiple accorded to FTL.

Key risk and concerns

Significant increase in raw material prices

Cotton & polyester yarn/fabric is the major raw material for FTL and volatility in cotton/polyester prices can impact the margin profile of the company. Since the second half of CY20, cotton/polyester prices have been trending higher owing to supply crunch and increased demand from downstream industries. If cotton/polyester prices continue to remain elevated for an elongated period, it can negatively impact margins for FTL, going ahead.

High dependence on US exports, currency risk

Around 60% of FTL's export revenues are derived from the US. Thus, any slowdown in the US market can significantly impact the order book and revenue visibility for the company. Also, as ~ 90% of revenues are generated from the export business, hence, any sharp movement in foreign currencies can negatively impact the margins of the company.

Inability to maintain optimum utilisation levels

Maintaining optimum utilisation levels is the key to sustenance of profit margins. If the company is unable to penetrate newer markets and/or generate incremental revenues from existing markets it can lead to sub optimal utilisation level of its expanded capacity. Lower utilisation of expanded capacity can lead to under absorption of fixed cost, which can negatively impact the margins of the company.

Financial Summary

Exhibit 3: Profit & Loss statement

(Year-end March)	FY21	FY22E	FY23E	FY24E
Net Sales	324.2	480.0	561.6	662.7
Growth (%)	7.3	48.1	17.0	18.0
Total Raw Material Cost	151.6	208.8	258.3	304.8
Gross Margins (%)	53.2	56.5	54.0	54.0
Employee Expenses	51.3	67.2	75.8	88.1
Other Expenses	73.5	126.2	139.8	163.0
Total Operating Expenditure	276.4	402.2	474.0	556.0
EBITDA	47.8	77.8	87.6	106.7
EBITDA Margin	14.7	16.2	15.6	16.1
Interest	5.7	6.5	5.2	4.2
Depreciation	8.8	9.7	12.4	12.7
Other Income	2.1	6.0	6.2	6.4
Exceptional Expense	-	-	-	-
PBT	35.4	67.5	76.1	96.2
Total Tax*	10.4	19.6	19.2	24.2
Profit After Tax	25.0	47.9	57.0	72.0

*Source: Company, ICICI Direct Research; * - tax rate is higher in FY21/FY22E owing to company adopting old tax regime. Company to shift to new lower tax rate from FY23E.*

Exhibit 4: Cash Flow Statement

(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit/(Loss) after taxation	25.0	47.9	57.0	72.0
Add: Depreciation	8.8	9.7	12.4	12.7
Net Increase in Current Assets	-44.7	-63.0	-24.6	-34.0
Net Increase in Current Liabilities	10.8	11.0	3.1	1.8
CF from operating activities	**-0.1**	**5.6**	**48.0**	**52.4**
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-15.4	-55.0	-25.0	-15.0
Others	5.7	0.0	0.0	0.0
CF from investing activities	**-9.7**	**-55.0**	**-25.0**	**-15.0**
Inc / (Dec) in Equity Capital	0.0	0.0	0.0	0.0
Inc / (Dec) in Loan	37.0	38.9	-26.2	-20.8
Others	-1.0	0.0	0.0	0.0
CF from financing activities	**36.0**	**38.9**	**-26.2**	**-20.8**
Net Cash flow	26.2	-10.4	-3.2	16.6
Opening Cash	16.3	42.4	32.0	28.9
Closing Cash	**42.4**	**32.0**	**28.9**	**45.5**

Source: Company, ICICI Direct Research

Exhibit 5: Balance Sheet

(Year-end March)	FY21	FY22E	FY23E	FY24E
Equity Capital	24.3	24.3	24.3	24.3
Reserve and Surplus	201.8	249.8	306.7	378.7
Total Shareholders funds	226.2	274.1	331.1	403.0
Total Debt	91.6	130.5	104.4	83.5
Non Current Liabilities	11.0	11.0	11.0	11.0
Source of Funds	**328.8**	**415.6**	**446.4**	**497.5**
Gross block	230.9	285.9	310.9	325.9
Less: Accum depreciation	100.0	109.7	122.1	134.8
Net Fixed Assets	130.9	176.2	188.8	191.1
Capital WIP	1.0	1.0	1.0	1.0
Intangible assets	-	-	-	-
Investments	0.2	0.2	0.2	0.2
Inventory	69.8	111.8	123.1	136.2
Cash	42.5	32.0	28.9	45.5
Debtors	69.7	89.4	100.0	118.0
Loans & Advances & Other CA	25.4	26.6	29.3	32.2
Total Current Assets	207.3	259.9	281.3	331.8
Creditors	13.3	23.7	26.2	27.2
Provisions & Other CL	14.4	15.1	15.7	16.4
Total Current Liabilities	27.8	38.7	41.9	43.6
Net Current Assets	179.5	221.1	239.4	288.2
LT L& A, Other Assets	17.1	17.1	17.1	17.1
Other Assets	0.0	0.0	0.0	0.0
Application of Funds	**328.8**	**415.6**	**446.4**	**497.5**

Source: Company, ICICI Direct Research

Exhibit 6: Key Ratios

(Year-end March)	FY21	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	10.3	19.7	23.4	29.6
Cash EPS	13.9	23.7	28.5	34.8
BV	93.0	112.7	136.1	165.7
DPS	0.0	0.0	0.0	0.0
Cash Per Share	17.5	13.2	11.9	18.7
Operating Ratios (%)				
EBITDA margins	14.7	16.2	15.6	16.1
PBT margins	10.9	14.1	13.6	14.5
Net Profit margins	7.7	10.0	10.1	10.9
Inventory days	78.6	85.0	80.0	75.0
Debtor days	78.4	68.0	65.0	65.0
Creditor days	15.0	18.0	17.0	15.0
Return Ratios (%)	142.1	135.0	128.0	125.0
RoE	11.1	17.5	17.2	17.9
RoCE	12.9	18.3	18.7	20.6
RoIC	15.0	19.9	20.1	22.8
Valuation Ratios (x)				
P/E	28.2	14.7	12.4	9.8
EV / EBITDA	15.8	10.3	8.9	7.0
EV / Sales	2.3	1.7	1.4	1.1
Market Cap / Revenues	2.2	1.5	1.3	1.1
Price to Book Value	3.1	2.6	2.1	1.7
Solvency Ratios				
Debt / Equity	0.4	0.5	0.3	0.2
Debt/EBITDA	1.9	1.7	1.2	0.8
Current Ratio	5.9	5.9	6.0	6.6
Quick Ratio	3.4	3.0	3.1	3.4

Source: Company, ICICI Direct Research

Key risks to investing in Nano stocks

- Nano stocks may not be in the limelight and inherently being micro cap in nature will have a high risk return profile
- We advise clients to be disciplined in investing at all times. Allocate only a small proportion of your investible income to these stocks and diversify well
- Try to diversify your exposure within the Nano stocks as well by investing equal proportions in several picks
- These stocks may have low volumes and trade infrequently
- Micro cap stocks the world over are, to a large extent, affected by the “Pump and Dump” phenomenon of inflated price buying and depressed price selling
- As explained above, the clients should be patient and trade only through limit orders on any side of the trade.
- The risk of volatility remains in such micro cap stocks as they can move up or down with large buy/sell orders
- The fair value of Nano stocks is subject to expected growth potential in the future. Though due diligence has been done to a fair extent, the actualisation of growth still has a degree of uncertainty attached to it

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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