Faze Three (FAZTHR)

ICICI direct Research

CMP: ₹ 367 | Target: ₹ 385 (5%) | Target Period: 12 months | **HOLD**

August 10, 2022

Steady performance in seasonally weak quarter….

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

Q1FY23: Reported highest ever Q1 sales driven by robust demand.

- Sales grew 50% YoY to ₹ 147 crore (de-grew 5% QoQ). The company operated at 100% utilisation levels in Q1FY23
- Judicious price hikes and improved product mix resulted in the company maintaining its gross margins at 55% (up 158 bps YoY)
- EBITDA margins improved 250 bps YoY to 16%. Steady operational performance led to YoY PAT growth of 60% (down 7% QoQ) to ₹ 14.6 crore

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 ~29% CAGR over the period. Near term challenges (spike in cotton/polyester yarn prices, slowdown in key export markets) may persist but we believe there is enough headroom for sustainable long term growth.

- We maintain **HOLD** rating on the stock with a revised target price

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

Key triggers for future price performance:

- It is currently operating at peak utilisation levels and has a healthy order book despite a challenging business environment
- 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 revenue, earnings CAGR of 15%, 19%, respectively, in FY22-24E

Alternate Stock Idea: Besides Faze Three, we also like Gokaldas Exports (GEL).

- GEL is one of India's leading apparel exporter with an annual capacity of 30 million pieces, which focus on manufacturing complex garmenting

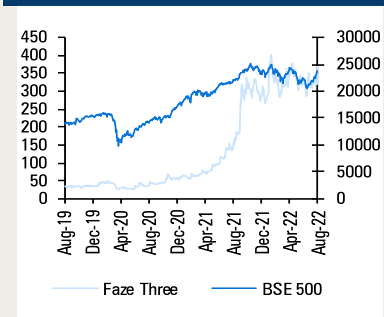
Particulars

Particulars	Amount
Market Capitalisation (₹ crore)	892.5
Total Debt (FY22) (₹ crore)	157.9
Cash (FY22) (₹ crore)	66.7
EV (₹ crore)	983.8
52 Week H / L	413 /138
Equity Capital (₹ crore)	24.3
Face Value (₹)	10.0

Shareholding pattern

	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	49.5	50.3	51.3	51.3	51.5
FII	2.5	-	-	-	-
DII	-	-	-	-	-
Others	48.0	49.7	48.7	48.7	48.6

Price Chart



Key risks

(i) Easing of input cost can improve margins (ii) Slowdown in US markets (~60% of sales) can impact order book

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Result Update

ICICI Securities – Retail Equity Research

Key Financial Summary

Financials	FY19	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Net Sales	268.6	302.2	324.2	504.5	16.0%	580.1	670.0	15.2%
EBITDA	28.0	34.8	47.8	79.6	26.0%	90.5	105.9	15.3%
EBITDA Margin (%)	10.4	11.5	14.7	15.8		15.6	15.8	
Net Profit	15.1	19.3	25.0	51.1		60.4	71.8	18.5%
EPS (₹)	6.2	7.9	10.3	21.0		24.8	29.5	
P/E (x)	59.3	46.3	35.7	17.5		14.8	12.4	
EV/EBITDA (x)	33.6	26.8	19.7	12.4		10.8	8.8	
RoCE (%)	9.7	12.1	12.9	17.5		18.3	19.5	
RoE (%)	8.1	9.6	11.1	18.4		17.8	17.5	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

- In Q1FY23, the company reported best ever Q1 revenues for the company. On the order book visibility front the management indicated that it has settled from euphoric levels, which was visible last year to realistic in current year across all legacy products. However, momentum of new products/development pipeline /orders has been largely unaffected despite potentially challenging global business environment evolving in the last four to five months
- The company believes that risk of high cotton prices has receded as prices have eased significantly and are expected to further soften. On the manmade fibre front, polyester prices are yet to cool off given the elevated crude prices and currency depreciation impact. However, the company believes that it will be able to maintain margins with a positive bias due to likely softening of input prices and depreciation of the rupee
- On the capacity expansion front, the management indicated that all capex plans are progressing as per schedule and the company is well prepared to garner higher revenues as and when demand stabilises
- The company also highlighted that its products are largely positioned in the price band of $10-25 per piece/per set band for sale by retailers, which empirically has not seen significant reduction in demand even in tough times
- On the long term growth prospects, China plus one sentiment continues to enhance sourcing of value added MMF textile merchandise from India. Also, economic challenges faced by neighbouring countries and their cotton textile sector are also helping Indian exporters. Ban on cotton from China has now been implemented globally and the management believes this could lead to significant benefits for Indian textile exporters. To benefit from long term positive macro variables, the company is building capacities/capabilities across its product bouquet
- The management indicated that the impact of higher logistics costs is negligible as 95% of its business is on FOB basis thereby insulating the company from escalation in shipping costs
- Despite various challenges, FY22 was a landmark year for the company as it reported its highest ever revenues (₹ 500 crore). For FY22, out of total revenue growth of 56%, volume growth was 45% and the rest was contributed by higher prices due to general inflationary trend. 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 FY22. The company's utilisation rates got enhanced significantly from 65% in FY21 to 95%+ in FY22
- In a bid to capture long term growth opportunities, the company has embarked on brownfield capacity expansion and outlined capex worth ₹ 80 crore (~₹ 40 crore already incurred). 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 healthy order inflows, going ahead, given the nature of the business where clients tend to be sticky and its niche positioning among 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
- Capital deployment towards value accretive projects to generate incremental RoCE of 25%+. Hence, we expect RoIC to improve from 15% in FY21 to 22% in FY24E. Also, with steady FCF generation, going forward, we expect D/E ratio to decline to 0.2x by FY24E

Financial Summary

Exhibit 1: Profit and loss statement				₹ crore
(Year-end March)	**FY21**	**FY22A**	**FY23E**	**FY24E**
Net Sales	324.2	504.5	580.1	670.0
Growth (%)	7.3	55.6	15.0	15.5
Total Raw Material Cost	151.6	218.8	266.9	306.9
Gross Margins (%)	53.2	56.6	54.0	54.2
Employee Expenses	51.3	65.2	77.2	87.1
Other Expenses	73.5	140.9	145.6	170.2
Total Operating Expenditure	276.4	424.9	489.6	564.2
EBITDA	47.8	79.6	90.5	105.9
EBITDA Margin	14.7	15.8	15.6	15.8
Interest	5.7	5.0	4.4	4.0
Depreciation	8.8	10.2	12.5	13.2
Other Income	2.1	7.0	7.2	7.3
Exceptional Expense	-	-	-	-
PBT	35.4	71.4	80.7	95.9
Total Tax*	10.4	20.3	20.3	24.1
Profit After Tax	25.0	51.1	60.4	71.8

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement				₹ crore
(Year-end March)	**FY21**	**FY22A**	**FY23E**	**FY24E**
Profit/(Loss) after taxation	25.0	51.1	60.4	71.8
Add: Depreciation	8.8	10.2	12.5	13.2
Net Increase in Current Assets	-44.7	-75.8	-37.9	-31.4
Net Increase in Current Liabilitie	10.8	11.1	6.1	1.3
CF from operating activiti	**-0.1**	**-3.4**	**41.1**	**54.9**
(Inc)/dec in Investments	0.0	-10.2	-1.0	-1.1
(Inc)/dec in Fixed Assets	-15.4	-43.0	-32.1	-15.0
Others	5.7	1.7	0.0	0.0
CF from investing activitie	**-9.7**	**-51.5**	**-33.1**	**-16.1**
Inc / (Dec) in Equity Capital	0.0	0.0	0.0	0.0
Inc / (Dec) in Loan	37.0	66.3	-31.6	-25.2
Others	-1.0	2.6	0.0	0.0
CF from financing activitie	**36.0**	**68.9**	**-31.6**	**-25.2**
Net Cash flow	26.2	14.0	-23.5	13.5
Opening Cash	16.3	42.4	56.5	32.9
Closing Cash	**42.4**	**56.5**	**32.9**	**46.4**

Source: Company, ICICI Direct Research

Exhibit 3: Balance Sheet				₹ crore
(Year-end March)	**FY21**	**FY22A**	**FY23E**	**FY24E**
Equity Capital	24.3	24.3	24.3	24.3
Reserve and Surplus	201.8	254.0	314.4	386.2
Total Shareholders funds	226.2	278.3	338.7	410.5
Total Debt	91.6	157.9	126.3	101.1
Non Current Liabilities	11.0	12.5	12.5	12.5
Source of Funds	**328.8**	**448.7**	**477.5**	**524.1**
Gross block	230.9	271.0	306.0	321.0
Less: Accum depreciation	100.0	110.2	122.7	135.9
Net Fixed Assets	130.9	160.8	183.2	185.1
Capital WIP	1.0	4.0	1.0	1.0
Intangible assets	-	0.0	0.0	0.0
Investments	0.2	10.4	11.4	12.6
Inventory	69.8	115.1	127.2	137.7
Cash	42.5	56.5	32.9	46.4
Debtors	69.7	81.8	103.3	119.3
Loans & Advances & Other CA	25.4	43.8	48.1	52.9
Total Current Assets	207.3	297.1	311.5	356.4
Creditors	13.3	21.7	27.0	27.5
Provisions & Other CL	14.4	17.3	18.0	18.8
Total Current Liabilities	27.8	38.9	45.0	46.3
Net Current Assets	179.5	258.2	266.5	310.1
LT L& A, Other Assets	17.1	15.3	15.3	15.3
Other Assets	0.0	0.0	0.0	0.0
Application of Funds	**328.8**	**448.7**	**477.5**	**524.1**

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios				
(Year-end March)	**FY21**	**FY22A**	**FY23E**	**FY24E**
Per share data (₹)				
EPS	10.3	21.0	24.8	29.5
Cash EPS	13.9	25.2	30.0	34.9
BV	93.0	114.4	139.3	168.8
DPS	0.0	0.0	0.0	0.0
Cash Per Share	17.5	23.2	13.5	19.1
Operating Ratios (%)				
EBITDA margins	14.7	15.8	15.6	15.8
PBT margins	10.9	14.2	13.9	14.3
Net Profit margins	7.7	10.1	10.4	10.7
Inventory days	78.6	83.3	80.0	75.0
Debtor days	78.4	59.2	65.0	65.0
Creditor days	15.0	15.7	17.0	15.0
Return Ratios (%)	142.1	126.8	128.0	125.0
RoE	11.1	18.4	17.8	17.5
RoCE	12.9	17.5	18.3	19.5
RoIC	15.0	20.9	20.3	22.1
Valuation Ratios (x)				
P/E	35.7	17.5	14.8	12.4
EV / EBITDA	19.7	12.4	10.8	8.8
EV / Sales	2.9	2.0	1.7	1.4
Market Cap / Revenues	2.8	1.8	1.5	1.3
Price to Book Value	3.9	3.2	2.6	2.2
Solvency Ratios				
Debt / Equity	0.4	0.6	0.4	0.2
Debt/EBITDA	1.9	2.0	1.4	1.0
Current Ratio	5.9	6.2	6.2	6.7
Quick Ratio	3.4	3.2	3.4	3.7

Source: Company, ICICI Direct Research

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