Faze Three (FAZTHR)

CMP: ₹ 310 | Target: ₹ 350 (13%) | Target Period: 12 months | **HOLD**

November 9, 2022

Result Update

Resilient show in challenging scenario….

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 home textile products in multiple categories (apart from bed sheets, towels that currently other listed players specialise in) with bathmats and 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 commitment

Q2FY23 Result: Maintained healthy double digit margins amid volatile RM scenario. Operated at utilisation level of 85%+ (vs. other home textile players: 50-60%)

- On a YoY basis, sales grew 17% YoY (down 7% QoQ) to ₹ 137.0 crore
- Despite volatility in RM prices (cotton/polyester), the company maintained EBITDA margins at 17.4% (Q1FY23: 16%, Q2FY22: 17.8%). Absolute EBITDA grew 14% YoY (2% QoQ) to ₹ 24 crore
- PAT grew 6% YoY to ₹ 14.4 crore (down 2% QoQ)

What should investors do? Over the past five years, the impact of FTL's improved financial performance has been visible in the upward momentum in stock price, which has grown at ~25% CAGR over the period. Near term challenges (slowdown in key export markets, inventory de-stocking by retailers) 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 ₹ 350 i.e. 12x FY24E EPS.

Key triggers for future price performance:

- Decent order book visibility for H2FY23 could sustain the current quarterly run rate. New products, development pipeline, orders are showing encouraging signs and improving sentiments vs. H1FY23
- 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 is 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 on sourcing to India from China across the company's product categories to create sustained demand
- We build revenue, earnings CAGR of 14%, 17%, 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 36 million pieces, which focuses on manufacturing complex garments

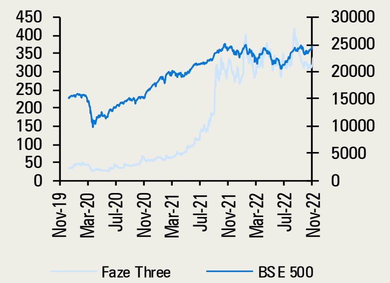
Particulars

Particulars	Amount
Market Capitalisation (₹ crore)	753.9
Total Debt (FY22) (₹ crore)	157.9
Cash (FY22) (₹ crore)	66.7
EV (₹ crore)	845.2
52 Week H / L	434 /261
Equity Capital (₹ crore)	24.3
Face Value (₹)	10.0

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	50.3	51.3	51.3	51.5	51.5
FII	-	-	-	-	-
DII	-	-	-	-	-
Others	49.7	48.7	48.7	48.6	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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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%	575.1	656.7	14.1%
EBITDA	28.0	34.8	47.8	79.6	26.0%	89.7	103.8	14.2%
EBITDA Margin (%)	10.4	11.5	14.7	15.8		15.6	15.8	
Net Profit	15.1	19.3	25.0	51.1		59.8	70.2	17.2%
EPS (₹)	6.2	7.9	10.3	21.0		24.6	28.9	
P/E (x)	50.1	39.1	30.1	14.8		12.6	10.7	
EV/EBITDA (x)	28.7	22.8	16.8	10.6		9.3	7.6	
RoCE (%)	9.7	12.1	12.9	17.5		18.2	19.2	
RoE (%)	8.1	9.6	11.1	18.4		17.7	17.2	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

- The company registered revenues of ₹ 284 crore in H1FY23 and is expecting a similar run rate to continue for H2FY23. It expects to exit FY23 with 14-15% topline growth
- The company operates on a made to order business model. During the last few months, the company did not accept orders that were low margin or unviable, which curtailed its revenue growth. The company was targeting revenues of ₹ 325 crore in H1FY23
- The order book visibility has improved in the last 45 days. The company is in talks with customers for orders relating to February and March 2023. The management indicated that majority of the customers have been able to reduce their old inventory and are gearing up for orders for the new season. The management highlighted that customers appear to be comfortable at giving orders at the current price, which should provide thrust to the order book position in the ensuing quarters
- 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 raw material scenario, the management indicated that cotton prices have softened though polyester prices are still high. Also, the company uses coarse count raw material, the prices of which have reduced and are at acceptable levels. The company believes it will be able to maintain margins with a positive bias due to likely softening of input prices and depreciation of the rupee
- The supply chain issues have been resolved, to a large extent, with freight rates declining from peak levels while the availability of containers has also improved, which would enable the company to operate as per its normal order cycle period
- The management indicated that all capex plans are being executed as per original schedule despite prediction of a slowdown/recession of retail sales in the US in Q2, Q3 of CY2023. With the enhanced capacities, the company expects to benefit from the revival of sentiment and improved demand in FY24, FY25 after demand normalises post the current recessionary trends
- The company is planning to introduce new products like value added rugs and bathmats, which have a better margin profile than the existing product portfolio that should aid in maintaining a positive momentum on the EBITDA margin, going ahead
- 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. 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
- 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, FTL has chalked out a plan to build 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

Financial Summary

Exhibit 1: Profit and loss statement ₹ crore

(Year-end March)	FY21	FY22A	FY23E	FY24E
Net Sales	324.2	504.5	575.1	656.7
Growth (%)	7.3	55.6	14.0	14.2
Total Raw Material Cost	151.6	218.8	264.5	300.8
Gross Margins (%)	53.2	56.6	54.0	54.2
Employee Expenses	51.3	65.2	76.5	85.4
Other Expenses	73.5	140.9	144.3	166.8
Total Operating Expenditure	276.4	424.9	485.4	553.0
EBITDA	47.8	79.6	89.7	103.8
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	79.9	93.8
Total Tax*	10.4	20.3	20.1	23.6
Profit After Tax	25.0	51.1	59.8	70.2

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	59.8	70.2
Add: Depreciation	8.8	10.2	12.5	13.2
Net Increase in Current Assets	-44.7	-75.8	-35.9	-28.3
Net Increase in Current Liabilitie	10.8	11.1	5.9	1.0
CF from operating activities	**-0.1**	**-3.4**	**42.3**	**56.1**
(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 activities	**-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 activities	**36.0**	**68.9**	**-31.6**	**-25.2**
Net Cash flow	26.2	14.0	-22.4	14.7
Opening Cash	16.3	42.4	56.5	34.1
Closing Cash	**42.4**	**56.5**	**34.1**	**48.8**

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	313.8	384.0
Total Shareholders funds	226.2	278.3	338.1	408.4
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**	**476.9**	**521.9**
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	126.0	134.9
Cash	42.5	56.5	34.1	48.8
Debtors	69.7	81.8	102.4	117.0
Loans & Advances & Other CA	25.4	43.8	48.1	52.9
Total Current Assets	207.3	297.1	310.7	353.7
Creditors	13.3	21.7	26.8	27.0
Provisions & Other CL	14.4	17.3	18.0	18.8
Total Current Liabilities	27.8	38.9	44.8	45.8
Net Current Assets	179.5	258.2	265.9	307.9
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**	**476.9**	**521.9**

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios

(Year-end March)	FY21	FY22A	FY23E	FY24E
Per share data (₹)				
EPS	10.3	21.0	24.6	28.9
Cash EPS	13.9	25.2	29.8	34.3
BV	93.0	114.4	139.0	167.9
DPS	0.0	0.0	0.0	0.0
Cash Per Share	17.5	23.2	14.0	20.1
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	17.7	17.2
RoCE	12.9	17.5	18.2	19.2
RoIC	15.0	20.9	20.2	21.9
Valuation Ratios (x)				
P/E	30.1	14.8	12.6	10.7
EV / EBITDA	16.8	10.6	9.3	7.6
EV / Sales	2.5	1.7	1.5	1.2
Market Cap / Revenues	2.3	1.5	1.3	1.1
Price to Book Value	3.3	2.7	2.2	1.8
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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