# Faze Three (FAZTHR)

ICICI direct Research

Result Update

| CMP: ₹ 342 | Target: ₹ 405 (19%) | Target Period: 12 months | BUY |
|---|---|---|---|

May 23, 2022

## Strong performance in tough environment….

**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

**Q4FY22**: Reported highest ever quarterly sales driven by robust demand.

- Sales on a high base grew 17% on a QoQ basis to ₹ 155.3 crore (up 43% YoY). The company operated at 100% utilisation levels in Q4FY22
- Owing to higher opex (up 39% QoQ), EBITDA margins declined 270 bps QoQ to 15% but still remain above its historical average (10-12%)
- Lower finance cost and taxation rate resulted in PAT growth of 25% QoQ (83% YoY) to ₹ 15.8 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 ~27% CAGR over the period. Near term challenges (spike in cotton/polyester yarn prices) may persist but we believe there is enough headroom for sustainable long term growth.

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

**Target Price and Valuation:** We value Faze Three at ₹ 405 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 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 revenue, earnings CAGR of 17%, 22%, respectively, in FY22-24E

**Alternate Stock Idea:** Besides Faze Three, we also like Gokaldas Exports.

- GEL is one of India's leading apparel exporter with an annual capacity of 30 million pieces which focuses on manufacturing complex garmenting
- BUY with target price of ₹ 570/share

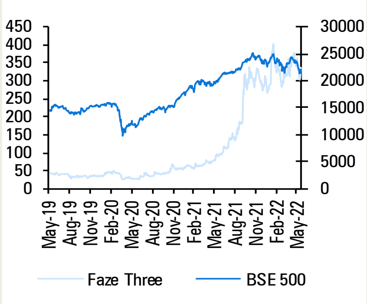
### Particulars

| Particulars | Amount |
|---|---|
| Market Capitalisation (₹ crore) | 831.7 |
| Total Debt (FY22) (₹ crore) | 157.9 |
| Cash (FY22) (₹ crore) | 66.7 |
| EV (₹ crore) | 923.0 |
| 52 Week H / L | 413 /88 |
| Equity Capital (₹ crore) | 24.3 |
| Face Value (₹) | 10.0 |

### Shareholding pattern

| | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
|---|---|---|---|---|---|
| Promoter | 49.5 | 49.5 | 50.3 | 51.3 | 51.3 |
| FII | 4.5 | 2.5 | - | - | - |
| DII | - | - | - | - | - |
| Others | 46.0 | 48.0 | 49.7 | 48.7 | 48.7 |

### Price Chart




### Key risks

(i) Inability to pass on higher yarn prices (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% | 590.2 | 693.5 | 17.2% |
| EBITDA | 28.0 | 34.8 | 47.8 | 79.6 | 26.0% | 92.1 | 111.7 | 18.4% |
| EBITDA Margin (%) | 10.4 | 11.5 | 14.7 | 15.8 | | 15.6 | 16.1 | |
| Net Profit | 15.1 | 19.3 | 25.0 | 51.1 | | 61.6 | 76.1 | 22.1% |
| EPS (₹) | 6.2 | 7.9 | 10.3 | 21.0 | | 25.3 | 31.3 | |
| P/E (x) | 55.3 | 43.1 | 33.3 | 16.3 | | 13.5 | 10.9 | |
| EV/EBITDA (x) | 31.5 | 25.0 | 18.4 | 11.6 | | 10.0 | 7.9 | |
| RoCE (%) | 9.7 | 12.1 | 12.9 | 17.5 | | 18.6 | 20.5 | |
| RoE (%) | 8.1 | 9.6 | 11.1 | 18.4 | | 18.1 | 18.3 | |

*Source: Company, ICICI Direct Research*

## Key takeaways of recent quarter

- 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 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
- EBITDA margins improved 100 bps YoY to 15.8% (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). FTL generally fixes the pricing of its products on a cost plus basis for each batch of orders. The raw material booking is done back to back when an order is received thereby more or less insulating the company's margin to be made from a specific order. Expects margins to be maintained at similar levels in H1FY23 (15-16%)
- Higher PAT margins (~10%) and better sweating of assets resulted in company reporting healthy RoCE of 18% (FY21: 13%, FY20: 12%). Short term debt increased to ₹ 157 crore (D/E: 0.6x) owing to higher working capital requirements (container shortage) and ongoing capex (~₹ 35 crore)
- On the raw material inflation, the company indicated that 40% of its raw material was polyester based which has seen lower inflation compared to cotton. Also the company uses coarser counts of cotton which has not increased in tandem with finer count cotton
- 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 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
- 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. 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 | 590.2 | 693.5 |
| Growth (%) | 7.3 | 55.6 | 17.0 | 17.5 |
| Total Raw Material Cost | 151.6 | 218.8 | 271.5 | 319.0 |
| Gross Margins (%) | 53.2 | 56.6 | 54.0 | 54.0 |
| Employee Expenses | 51.3 | 65.2 | 79.7 | 92.2 |
| Other Expenses | 73.5 | 140.9 | 147.0 | 170.6 |
| Total Operating Expenditure | 276.4 | 424.9 | 498.1 | 581.9 |
| **EBITDA** | 47.8 | 79.6 | 92.1 | 111.7 |
| EBITDA Margin | 14.7 | 15.8 | 15.6 | 16.1 |
| 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 | 82.3 | 101.7 |
| Total Tax* | 10.4 | 20.3 | 20.7 | 25.6 |
| **Profit After Tax** | 25.0 | 51.1 | 61.6 | 76.1 |

*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 | 61.6 | 76.1 |
| Add: Depreciation | 8.8 | 10.2 | 12.5 | 13.2 |
| Net Increase in Current Assets | -44.7 | -75.8 | -41.9 | -36.3 |
| Net Increase in Current Liabilities | 10.8 | 11.1 | 6.6 | 1.8 |
| **CF from operating activities** | **-0.1** | **-3.4** | **38.8** | **54.7** |
| (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 | -25.9 | 13.4 |
| Opening Cash | 16.3 | 42.4 | 56.5 | 30.5 |
| **Closing Cash** | **42.4** | **56.5** | **30.6** | **43.9** |

*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 | 315.6 | 391.7 |
| Total Shareholders funds | 226.2 | 278.3 | 339.9 | 416.0 |
| 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** | **478.7** | **529.6** |
| | | | | |
| 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 | 129.4 | 142.5 |
| Cash | 42.5 | 56.5 | 30.5 | 43.9 |
| Debtors | 69.7 | 81.8 | 105.1 | 123.5 |
| Loans & Advances & Other CA | 25.4 | 43.8 | 48.1 | 52.9 |
| Total Current Assets | 207.3 | 297.1 | 313.1 | 362.9 |
| Creditors | 13.3 | 21.7 | 27.5 | 28.5 |
| Provisions & Other CL | 14.4 | 17.3 | 18.0 | 18.8 |
| Total Current Liabilities | 27.8 | 38.9 | 45.5 | 47.3 |
| Net Current Assets | 179.5 | 258.2 | 267.6 | 315.6 |
| 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** | **478.7** | **529.6** |

*Source: Company, ICICI Direct Research*

Exhibit 4: Key ratios

| (Year-end March) | FY21 | FY22A | FY23E | FY24E |
|---|---|---|---|---|
| **Per share data (₹)** | | | | |
| EPS | 10.3 | 21.0 | 25.3 | 31.3 |
| Cash EPS | 13.9 | 25.2 | 30.5 | 36.7 |
| BV | 93.0 | 114.4 | 139.8 | 171.1 |
| DPS | 0.0 | 0.0 | 0.0 | 0.0 |
| Cash Per Share | 17.5 | 23.2 | 12.6 | 18.1 |
| **Operating Ratios (%)** | | | | |
| EBITDA margins | 14.7 | 15.8 | 15.6 | 16.1 |
| PBT margins | 10.9 | 14.2 | 13.9 | 14.7 |
| Net Profit margins | 7.7 | 10.1 | 10.4 | 11.0 |
| 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 | 18.1 | 18.3 |
| RoCE | 12.9 | 17.5 | 18.6 | 20.5 |
| RoIC | 15.0 | 20.9 | 20.5 | 23.0 |
| **Valuation Ratios (x)** | | | | |
| P/E | 33.3 | 16.3 | 13.5 | 10.9 |
| EV / EBITDA | 18.4 | 11.6 | 10.0 | 7.9 |
| EV / Sales | 2.7 | 1.8 | 1.6 | 1.3 |
| Market Cap / Revenues | 2.6 | 1.6 | 1.4 | 1.2 |
| Price to Book Value | 3.7 | 3.0 | 2.4 | 2.0 |
| **Solvency Ratios** | | | | |
| Debt / Equity | 0.4 | 0.6 | 0.4 | 0.2 |
| Debt/EBITDA | 1.9 | 2.0 | 1.4 | 0.9 |
| 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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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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