Faze Three Limited

July 22, 2020

Rating

Facilities	**Amount (Rs. crore)**	**Rating**[1]	**Rating Action**
Long term/Short term Bank Facilities	87.00 (enhanced from 82.00)	CARE BBB+; Stable/ CARE A3+ (Triple B Plus; Outlook: Stable/A Three Plus)	**Reaffirmed**
Total Facilities	87.00 (Rs. Eighty Seven crore only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to FTL continues to derive strength from the company's experience in manufacturing home furnishing products, integrated nature of operations, diversified product mix/customer base , growth in operations, improvement in PBILDT margins in FY20, comfortable capital structure and debt protection metrics. The ratings are however constrained by long operating cycle, geographical concentration of revenue (USA and UK markets), credit terms extended for domestic business to a group company, ability to manage / pass on fluctuations in raw material prices & Foreign Exchange rates and continuity of Govt policies on Export benefits.

Key rating Sensitivities

Positive Factors

- PBILDT margin above 12.00% on consistent basis
- Sustained increase in scale of operations

Negative factors

- Stretch in working capital cycle to 180 days
- Increase in overall gearing to 1.20x and above

Detailed description of the key rating drivers

Key Rating Strengths

Experienced Promoters

FTL is promoted by Mr. Ajay Anand, Chairman & Managing Director. He has about 35 years of experience in international marketing of home interiors/furnishings fabrics and made ups. He is supported by Mr. Sanjay Anand (Brother), whole time director of the company.

Improvement in capital structure and debt protection metrics

The overall gearing ratio improved from 0.52x as on March 31st 2019 to 0.37x as on March 31st 2020. This is due to the fact that the tangible net worth (TNW) increased from Rs.131.15 Cr in FY 19 to Rs.148.71 Cr in FY 20 due to ploughing back of profits. Further there was a reduction in working capital utilization from Rs. 64.11 core in FY19 to Rs. 53.39 crore in FY20 coupled with reduction of the term loan balance from Rs.3.36 cr in FY19 to Rs 1.28 cr in FY20. The PBIDLT interest coverage ratio remained stable at 4.51x in FY20 vis-à-vis 4.58x in FY19. The Total Debt to GCA improved from 3.35x in FY19 to 2.10x in FY20 due to reduction in Total Debt from Rs.67.63 cr in FY19 to Rs.54.73 cr in FY20 alongwith increase in GCA from Rs.20.18 cr in FY19 to Rs.26.04 cr in FY20.

Growth in revenue with improvement in profitability margins; margins susceptible to export benefits

FTL witnessed 14.60% increase in Total Income from Rs. 267.26 crore in FY19 to Rs. 306.26 crore in FY20. This can be mainly attributed to the growth in sales volumes in certain product categories such as Bathrugs, Bathmats and Cushions. The company has also diversified its product mix by adding couple of new products within the Home textile segment during FY 20 which has also contributed to higher sales. The profitability margins witnessed an improvement with the PBILDT margin increasing from 11.52% in FY19 to 12.68% in FY20. This can mainly be attributed to growth in Total Income and better recovery of Fixed overheads, the % Raw material costs to revenue remained stable at ~45%. The PAT margin remained stable

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

at 6.30% in FY20 vis-a-vis 6.10% in FY19. The company's ROCE has also improved from 13.59% in FY 19 to 15.97% in FY 20 due to lower levels of debt. The company's profitability is also significantly dependent on continuation of various export incentives from government for the Textile sector.

Strong and concentrated Customer Base; albeit moderate geographical risk
The aggregate sales generated from the top 10 clients amount to 73% of total sales (64% PY) of which, at least 6 customers have % share in sales > 10% each which shows moderate and marginally improving client concentration risk. Similarly, aggregate purchases from the top 10 suppliers amount to 45.85% of total purchases (42.79% PY). More than 85% of the company's revenue is from exports mainly to USA (53.37%), UK / EUR (29.25%) and balance to Canada, Australia, Japan, Korea etc, also resulting in moderate geographical concentration risk.

Impact of Covid19
FTL had to temporarily shut down operation on 23-March-20 due to the global pandemic COVID-19. However, the company resumed operations for all its facilities by first week of May 2020. The orders for the month of March that were stalled due to the lockdown got deferred and were processed in May. The company has undertaken cost reduction and rationalization measures for FY 21.The company has order book position on hand of over Rs.140 crore to be executed by Dec-Jan 2020 .

Key Rating Weaknesses

Long working capital cycle however improving over the period of years and elongated credit to group companies
FTL has an elongated working capital cycle owing to the working capital intensive nature of operations, given the specific skill and limitation of capacity involved in the handloom operations. Furthermore, most overseas retailers have been working on minimum credit period of 60 days going up to 120 days in few cases. Due to the sustained efforts of the management, FTL's inventory period has come down to 89 days in FY20 as against 127 days in FY17. The nature of operations and business model of the company is made to order business with strict delivery timelines for most business around 60-120 days keeps Inventory levels elevated. Furthermore, average collection period from customers has also reduced to 58 days in FY20 as against 78 days in FY17, resulting in FTL's cash conversion cycle improving over the past few years. The working capital cycle of the company has improved from 158 days in FY 19 to 137 days in FY 20.The company's receivable as on March 31st 2020 stood at Rs.45.55 crore (P.Y. Rs.44.96 crore) out of which Rs.18.10 crore (P.Y. Rs.15.48 crore) is receivable from related parties (Faze Three US LLC Rs.1.92 crore, Faze Three Autofab Limited (AFL) Rs.15.54 crore and Next Interiors Pvt. Ltd. Rs.0.64 crore). The sale from FTAL has mildly declined from Rs 23.64 cr in FY19 to Rs 22.37 cr in FY20. Any further credit extension to group companies remain key rating monitorable.

Susceptible to fluctuation in raw material prices and foreign exchange rates
The raw materials used by FTL are cotton, polyester yarn and latex. The cost of raw materials amounts to nearly 42.62% of total sales in FY20 (vis-à-vis 45% of total sales in FY19). The decline in raw material costs can be attributed to Cotton price movement depends on factors such as global demand-supply dynamics, area under cultivation, yield for the year, government regulation and pricing etc. Polyester yarn and synthetic latex are crude oil derivatives. Crude oil price movement depends on international factors such as output from OPEC, US-Iran sanctions, and global pricing factors. FTL's PBILDT margin remains susceptible to adverse movement in the raw material prices and its ability to pass on fluctuations in its pricing to the customers.
Exports usually contribute to approximately 90% of the total income of the company. It mostly exports to countries like USA, UK, Germany, Australia, South Africa, Brazil, Hong Kong and Canada and realizes 90% of its sales in USD. The company avails Packing Credit in rupee and Book forward contracts for its USD Receivables based on the policy followed by the company from time to time. As on March 31st 2020, foreign currency receivables that are unhedged amount to Rs. 29.73 crore. The company remains exposed to forex rates depending on its unhedged position.

<u>**Industry Outlook:**</u>

<u>Home Textile Segment</u>
Indian home furnishings comprises of bedspreads, furnishing fabrics, curtains, rugs, durries, carpets, placemats, cushion covers, table covers, linen, kitchen accessories, made-ups, bed spreads, bath linen and other home furnishings accessories. The demand in the home textile market is governed by the rise in disposable income of the households and improvement in the living standards. On the global level, United States and Europe are the two major markets in the segment; with India, China, Turkey, Pakistan and Bangladesh being the major suppliers. There is an emerging trend for supply chains for all products including Textiles moving out of China to other countries. This could also benefit the existing and established Indian Textile industry.

COVID-19-Impact on the Textile Segment

The Covid-19 pandemic is primarily expected to adversely impact exports and the domestic markets on account of the lockdown . The pandemic has affected the majority of India's export market (the US and EU together constitute for approximately, 60% of the total apparel exports from India in value terms), causing order cancellations/deferral of order leading to inventory build-up and expectation of slower realization of export receivables leading to higher working capital requirements. Additionally, domestic consumption is also getting impacted due to all India closure with people focusing majorly on essential items and commodities.
In the export area, now that Covid-19 has taken over key buying areas like Europe and the USA the impact will be severe especially on the suppliers of luxury fabrics and embroidery. For suppliers to fast fashion/mass retail, there might still be hope in the aftermath but initially, at least there will be smaller orders and very tight margins.

Liquidity analysis: Adequate

The working capital cycle has improved to 137 days in FY20 as compared to 158 days in FY19. This is on account of the decrease in the average inventory days from 108 days in FY19 to 89 days in FY20. The average monthly utilization of fund based limits for 12 months ended May 2020 was 73.10% on gross basis and at 64% on net basis (borrowing less cash on hand). The company has positive cash flow from operations in FY20. The Company does not have any significant repayment obligations in FY21 and routine capex of ~Rs. 4.00 Cr is expected, to be funded from internal accruals. As on 31-March-20, the cash balance available with the FTL was Rs. 14.71 crore and the net cash generated from operations for FYE 20 was Rs. 30.81 crore. The company also has a satisfactory quick ratio of 1.11x as on 31st March 2020

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning 'Outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology- Manufacturing Companies
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector

About the Company

Faze Three Limited (FTL), promoted by Mr. Ajay Anand in 1985, is a manufacturer and exporter of home furnishing textile products mainly floor coverings i.e. bathmats, rugs and top of the bed i.e. blankets and throws along with cushions. Company has a diversified its product mix across categories in Home Textile segment. Founded in 1985 with operations out of Panipat, Haryana, FTL came out with a public issue during the year 1995, post which it expanded in Vapi and Silvassa and also set up its first plant for automotive textiles by entering into joint Venture (JV) with Aunde Achter & Ebels GmBh, German multinational group (Aunde), which was later hived off in CY2000 as an independent unit and renamed as Aunde Faze Three Autofab Limited (AFTAL). In August 2019, equity held by Aunde in AFTAL was acquired by Mr Ajay Anand and the company was renamed as Faze Three Autofab Limited. FTL has 6 manufacturing facilities at Panipat, Silvassa and Vapi. FTL exports its Home Textile products furnishings mainly to USA, UK, Germany, Mexico, Canada and other countries.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	267.26	306.26
PBILDT	30.79	38.84
PAT	16.30	19.28
Overall gearing (times)	0.52	0.37
Interest coverage (times)	3.80	3.59

Status of non-cooperation with previous CRA: NA

Any other information: NA

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based/Non-fund-based-LT/ST	-	-	-	82.13	CARE BBB+; Stable / CARE A3+
Fund-based/Non-fund-based-LT/ST	-	-	-	4.87	CARE BBB+; Stable / CARE A3+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based/Non-fund-based-LT/ST	LT/ST	82.13	CARE BBB+; Stable / CARE A3+	-	1)CARE BBB+; Stable / CARE A3+ (24-Dec-19)	1)CARE BBB; Stable / CARE A3+ (04-Sep-18)	1)CARE BBB-; Stable (03-Oct-17) 2)CARE BBB-; Stable (17-Jul-17)
2.	Fund-based/Non-fund-based-LT/ST	LT/ST	4.87	CARE BBB+; Stable / CARE A3+	-	1)CARE BBB+; Stable / CARE A3+ (24-Dec-19)	1)CARE BBB; Stable / CARE A3+ (04-Sep-18)	1)CARE A3 (03-Oct-17) 2)CARE A3 (17-Jul-17)

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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