

Firstextile

Q3 results

Accelerating momentum

A second consecutive quarter of strong operating momentum, especially in the Fabrics and Uniforms segments, gives us confidence that FY operating guidance will at least be met, if not exceeded. However, increases in interest costs and tax mean that while the shape of our forecast has changed, our earnings forecasts are maintained. With the acceleration in operating performance and assurance that the new factory will come on stream in Q215, at 2.6x 2015 P/E the valuation looks attractive.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/12	179.5	41.2	3.46	0.0	1.9	N/A
12/13	200.3	40.1	2.79	0.0	2.4	N/A
12/14e	211.3	32.2	2.25	0.0	2.9	N/A
12/15e	253.6	35.5	2.56	0.0	2.6	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Strong performances from Fabrics and Uniforms

Q3 group revenues were up 46.2% y-o-y and 16% q-o-q, marking the second consecutive quarter of accelerating momentum. Gross profit was up 30.8% to €21.2m. The strong results were driven by an improving performance in Fabrics (revenues +3.3% and gross profit +7.4%) and an outstanding performance from Uniforms (revenues up tenfold and gross profit +930%), only partially offset by continued weakness in the Brands segment (revenues -45.4% at €5.2m, and gross profit -45.6% at €3.3m), reflecting the flexibility of the business model between its three operation to maintain stability in the overall group results.

Upgrade to revenue and gross margin forecasts

Due to the strong operational performance in Q3, we have upgraded our revenue and gross margin FY forecasts for the Fabrics and Uniforms segments ahead of the company's guided ranges. However, this has been partly offset by a downgrade to our forecast for the Branded segment. In total, we upgrade our revenue forecast by 8.9% to €211.3m, slightly ahead of the guided range of €190-€210m, and our gross margin forecast by 11.4% to €64m. Our EBIT margin forecast is now 16.9% in the middle of the 16-18% guided range. However, due to a step-up in interest costs and tax, our net profit forecast and EPS forecasts remain the same.

Valuation: Attractive

With the share price at €6.57, Firstextile is not only trading near its 12-month low (€6.39), but has also underperformed by -33.7% absolute and -34.7% relative to the DAX over the past 12 months. Given the accelerating momentum, both year-on-year and consecutively in Q2 and Q3, and recent management commitment to commencing production at the new factory (aimed at doubling capacity) in Q215, we believe the continued share price underperformance is now unfounded. At 2.6x 2015 P/E and 1.7x 2015 EV/EBITDA, the stock does not look expensive on either measure.

Textiles

20 November 2014

Price €6.57

Market cap €78m

€0.1294/0.1197RMB

Net cash (€m) at end Q3 9.7

Shares in issue 11.8m

Free float 16%

Code FT8

Primary exchange Frankfurt

Secondary exchange Xetra

Share price performance



Business description

Firstextile is a leading manufacturer of high-end yarn-dyed fabrics in the Chinese domestic market. It also markets fabrics and shirts for the Chinese premium segment. Firstextile listed in Frankfurt in November 2012 when it raised €18m gross.

Next events

EKF Forum presentation 26 November 2014

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Investment summary

Group results: A further acceleration in Q3

Q3 marks the second consecutive quarter of an encouraging acceleration in Firstextile's group performance. Reported group revenues were up 46.2% in Q314 versus Q313 at €69.3m, also reflecting a 16% increase from group revenues reported in Q214. The acceleration in revenue growth was driven predominantly by a more than tenfold increase in revenues from the Uniforms segment in the quarter, and a small acceleration in performance in the Fabrics segment of +3.3%.

Group gross profit increased by 30.8% in Q3 to €21.2m, and by 16% consecutively vs Q214, again due to the strong performances from the Uniforms and Branded segments. Group gross margin of 30.6% was down -350bp, principally due to the mix of performance, with the lower-margin Uniforms segment strongly outperforming the higher-margin Fabrics and Branded segments.

Group EBITDA increased by 36.3% in the quarter to €14.9m, also a 15.5% sequential increase on Q214. Group EBITDA margin was 150bp lower at 21.5%, in part resulting from the adverse product mix impact, but also from a 37.8% increase in fixed costs due to a step-up in distribution and selling costs as a result of a step-up in the compensation levels for sales staff, which is due to annualise in Q413.

Normalised PBT was up 30.4% in Q3, a slightly slower rate than EBITDA growth due to a step-up in the costs of financing as a result of entering into a long-term loan arrangement with Nomura in Q214, and a lower level of net cash, due to the investment in the new production facility and an increase in working capital requirement.

Net profit and EPS were up 31.0% and 30.9% respectively in Q3, based on an average share count of 11.8m.

The results for the first nine months reflect the very slow start in Q114, which has now been mostly compensated for by the acceleration in performance we have highlighted in both Q2 and Q3. Group revenues for the nine months to end September 2014 rose 5.2% to €161.8m; however, stripping out the weakness of the RMB relative to the euro, constant currency sales were up 8.2%. Group gross profits in the first nine months were up marginally (+0.7%) at €49.7m, reflecting a gross margin of 30.7% (-130bp versus the previous year). EBIT of €31.1 for the first nine months was down -5.3% year-on-year, giving an EBIT margin of 19.2% which, while -220bp versus the comparative period, is still above the top end of guidance given by the company for a 16-18% EBIT margin in 2014. Net profit and EPS for the period of €24.1m and €2.04 respectively reflect a decline of 7.8%.

Net cash at the end of the period was €9.7m, a decline from the €41.3m reported at end December 2013. This in part reflects the increased capex investment in the new production capacity (which the company recently disclosed was still expected to come on stream in Q215, with capex spend in the previously disclosed budget) and an increase in working capital, specifically receivables, as the group chose to increase advance payments to suppliers as part of a strategy to confront the exchange rate risk arising from the acquisition of the long-term loan with Nomura in US dollars.

Fabrics

Q3 revenues increased by 3.3% to €36.8m, but were -3.3% at €98.7m for the first nine months. On a constant currency basis, nine-month revenues were essentially flat. The acceleration in performance through Q2 and Q3 gives us confidence in the segment achieving its target revenues of €130-135m for the full year as it would only require €31.3-35.3m sales, representing -9.3% to +2.3% year-on-year revenue growth in Q4.

Gross profit in Q3 increased by 7.4% to €10.1m, a 100bp in gross margin improvement to 27.6%. For the first nine months gross profit declined by 7.8% and gross margin was down 140bp to

26.9%, although still at the very top end of the group's gross margin guidance for the fabrics sector in 2014 of 25-27%.

Uniforms

The standout business in the quarter was the Uniforms segment. Q3 revenues increased more than tenfold to €27.3 (although this growth rate is flattered by a particularly weak Q313 performance due to the lack of bulk orders received in that period). After a very quiet Q114, the acceleration in performance in Q2 (+22%), and more specifically Q3, meant that revenues for the first nine months to end September increased 52.3% to €47.7m, already well ahead of full year revenue guidance of €30-35m for this segment.

Gross profit in the segment was up 930% at €7.8m, giving a gross margin of 28.4%. For the first nine months gross profit was €13.7m, giving a gross margin of 28.8%, or a +790bp increase on the corresponding period in 2013. The improvement was partly driven by the improved fixed-cost leverage driven by the increase in revenues, but also because the bulk orders received by the group in the period were priced at a higher margin. The current gross margin guidance for the Uniforms segment for 2014 is 18-22% which, given 28.8% reported for the first nine months, we expect to be materially exceeded.

Firstextile is currently shortlisted for 20 government institutions and state-owned enterprises and sees excellent chances to significantly improve its status as selected shortlisted supplier in the mid to long term.

Branded products

Branded revenues decreased by 45.4% to €5.2m in Q3 and by 24.6% to €15.4m in the nine-month period to September 2014. The reason for the decline was a sharp decrease in demand in the corporate gifts sector, to which the Branded segment, through the manufacturer of shirts under the Firstextile brand, is disproportionately exposed to. Firstextile's strategy is to overcome this weakness through the expansion of its premium shirts business into a dedicated retail sales channel, and through the establishment of the VARPUM brand, which sells a far broader range of premium menswear products, as a leading brand in China. However, given the relative weighting of the Firstextile branded shirts through the wholesale channel relative to its own and VARPUM's sales through the dedicated retail channel, a short-term turnaround in this segment is unlikely.

Gross profit also declined materially by 45.6% in Q3 to €3.3m, representing a margin of 62.7%. Gross profit for the nine-month period fell by 32.9% to €9.4m, a 720bp margin decline to 61.1%, although this is still well above the gross margin guidance for the fabrics segment of 52-58% for 2014.

Forecasts and guidance

Management has reiterated guidance for FY14 of revenues of €190-210m and an EBIT margin of 16-18%. As Exhibit 1 shows, while our earnings forecast remains unchanged for the year, its shape has changed, driven by an upgrade to our overall revenue and gross margin assumptions, offset by increases in fixed costs, interest costs and tax.

Exhibit 1: Edison group revised forecasts and Firstextile guidance

€m	2014 old	2014 new	Change (%)	Guidance low	Guidance high
Revenue	194,000	211,337	8.9	190,000	210,000
Gross profit	57,450	63,988	11.4	53,500	65,550
EBITDA	37,477	39,706	5.9	N/A	N/A
EBIT	32,577	35,820	10.0	30,400	37,800
PBT	31,277	32,243	3.1	N/A	N/A
Net income	26,585	26,585	0.0	N/A	N/A
EPS (€)	2.25	2.25	0.0	N/A	N/A

Source: Edison Investment Research, company data

Exhibit 2: Financial summary

	€m	2011	2012	2013	2014e	2015e	2016e
December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		131.7	179.5	200.3	211.3	253.6	354.0
Cost of Sales		(91.0)	(123.1)	(135.5)	(147.3)	(180.9)	(255.2)
Gross Profit		40.7	56.4	64.8	64.0	72.7	98.8
EBITDA		32.0	46.2	45.1	39.7	46.5	61.8
Operating Profit (before amort. and except.)		29.4	43.1	41.6	35.8	38.5	53.5
Intangible Amortisation		0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals		0.0	(3.0)	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0	0.0
Operating Profit		29.4	40.1	41.6	35.8	38.5	53.5
Net Interest		(1.5)	(1.9)	(1.5)	(3.6)	(3.0)	(0.8)
Profit Before Tax (norm)		27.9	41.2	40.1	32.2	35.5	52.7
Profit Before Tax (FRS 3)		27.9	38.2	40.1	32.2	35.5	52.7
Tax		(3.9)	(5.7)	(7.2)	(5.7)	(5.3)	(7.9)
Profit After Tax (norm)		23.9	35.5	32.9	26.6	30.2	44.8
Profit After Tax (FRS 3)		23.9	32.5	32.9	26.6	30.2	44.8
Average Number of Shares Outstanding (m)		10.0	10.3	11.8	11.8	11.8	11.8
EPS - normalised fully diluted (€)		2.39	3.46	2.79	2.25	2.56	3.79
EPS - (IFRS) (€)		2.39	3.17	2.79	2.25	2.56	3.79
Dividend per share (c)		0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)		30.9	31.4	32.3	30.3	28.7	27.9
EBITDA Margin (%)		24.3	25.7	22.5	18.8	18.3	17.4
Operating Margin (before GW and except.) (%)		22.3	24.0	20.8	16.9	15.2	15.1
BALANCE SHEET							
Fixed Assets		33.7	31.9	47.4	88.2	100.2	101.9
Intangible Assets		0.0	0.0	0.0	0.0	0.0	0.0
Tangible Assets		33.6	31.8	47.1	88.2	100.2	101.9
Deferred tax assets		0.1	0.1	0.3	0.0	0.0	0.0
Current Assets		65.1	110.4	137.9	125.0	150.4	193.5
Stocks		7.2	13.5	12.5	20.0	40.0	30.0
Debtors		32.2	47.5	53.5	60.0	70.0	75.0
Cash		25.7	49.5	72.0	45.0	40.4	88.5
Other		0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities		(50.2)	(43.7)	(59.1)	(64.2)	(68.2)	(73.2)
Creditors		(23.1)	(14.0)	(28.4)	(33.5)	(37.5)	(42.5)
Short term borrowings		(27.1)	(29.7)	(30.7)	(30.7)	(30.7)	(30.7)
Long Term Liabilities		0.0	0.0	0.0	0.0	0.0	0.0
Long term borrowings		0.0	0.0	0.0	0.0	0.0	0.0
Other long term liabilities		0.0	0.0	0.0	0.0	0.0	0.0
Net Assets		48.7	98.6	126.2	149.0	182.5	222.2
CASH FLOW							
Operating Cash Flow		25.4	14.2	50.5	27.6	24.0	66.9
Net Interest		(1.5)	(1.9)	(1.5)	(3.6)	(3.0)	(0.8)
Tax		(1.5)	(4.8)	(6.4)	(6.0)	(5.5)	(8.0)
Capex		(2.7)	(1.6)	(19.6)	(45.0)	(20.0)	(10.0)
Acquisitions/disposals		0.0	0.0	0.0	0.0	0.0	0.0
Financing		0.0	15.6	(0.3)	0.0	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Flow		19.6	21.5	22.8	(27.0)	(4.5)	48.1
Opening net debt/(cash)		19.4	1.4	(19.8)	(41.3)	(14.3)	(9.8)
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0	0.0
Other		(1.6)	(0.2)	(1.3)	0.0	0.0	0.0
Closing net debt/(cash)		1.4	(19.8)	(41.3)	(14.3)	(9.8)	(57.8)

Source: Company accounts, Edison Investment Research

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