

Mossberg's Investor Digest

Best Idea Profile

Physicians Formula Holdings, Inc. (NASDAQ:FACE)

DESCRIPTION:

Headquartered in Azusa, California; Physicians Formula Holdings, Inc. is one of the ten largest mass market cosmetics companies in the U.S. FACE specializes in developing and marketing innovative, premium-priced products which it sells to retailers such as Wal-Mart, CVS, Target and Rite Aid. The company's product portfolio includes items for specific, everyday cosmetics needs and includes face powders, bronzers, blushes, foundations, eye liners, and mascaras. These products appeal to a broad consumer base by selling products offering similar quality and benefits as those sold in department stores and high-end specialty retailers, but at lower price points. Over the last 3 years, FACE has introduced an average of 97 new products each year including 46 in 2010. FACE plans to continue to expand using additional distribution and product development.

KEY INVESTMENT CONSIDERATIONS:

Large Established Market Niche - FACE competes in a large and lucrative "masstige" cosmetics market. This is a large market that sells premium products through large retailers at prices below that of "high end" department store cosmetics. FACE has a well developed sales channel with products selling in approximately 23,700 of the 45,000 stores which it has identified as targets. Though sales declined recently due to SKU rationalizations during the recession, it has experienced strong long-term growth. From 2003 through 2007, net sales grew at 21% (CAGR) with gross profits up 20% (CAGR) during the same period.

Growing Market Penetration - Physicians has experienced strong growth in the square footage dedicated to its in-store product sales. From 2002 to 2008, FACE experienced a 12.3% (CAGR) in store space with linear square feet growing from 1.6M to 3.2M. FACE has an intermediate term goal of 6M to 8M sq. ft., which would make it 6th in its competitive niche.

Recent Refinancing - On April 30th, the company's shareholders approved an attractive refinancing with its largest shareholder. In exchange for 650,000 warrants (exercise price of \$0.25), the term of \$8 million in subordinated debt was extended by 1 ½ years and the cash coupon was reduced from 15% to 10%. The company expects to save \$400,000 in pre-tax expense from the refinancing. During 4Q09, FACE refinanced its bank debt with an asset based lending program with Wells Fargo that provides for borrowings up to \$25MM.

Strong Value Proposition - The company's innovative, high-quality products sell at premium price points which generate a high return on investment for retailers. Physicians' brands enjoy a broad appeal to affluent consumers that cut across different age groups and ethnicities. The company believes consumer demand for its products has motivated its retail customers to increase the square footage and number of stores used to sell its line of products.

New Management - Jeff Rogers has served as Physicians Formula's President since August 2006. Mr. Rogers worked at Revlon, Inc., a manufacturer and marketer of cosmetics, skincare, fragrances and personal care products, and Del Laboratories, Inc. On February 22, 2010 the company announced the appointment of Jeff Berry as its new CFO.

VALUATION:

Physicians Formula is a solid franchise with good growth potential. The company reported \$9.4 million in net cash from operations during 2009 in an extremely difficult environment. After rationalizing 28% of its SKU's and reformulating its product mix during 2009, the company expects to resume top line growth in 2010. With a price to sales of 0.5x, FACE is a cheap stock for a story with a strong possibility of near-term top line growth. As growth resumes, FACE should be able to command a 1x multiple of sales or higher...significant upside from current levels.

(NASDAQ: FACE)

Investment Data (as of 4/30/10)

Recent Price	\$3.04
52-Week Range	1.03 - 4.23
Fiscal Year End	December
Shares Outstanding	13.6MM
Average Trading Volume (3 mos)	30,000
Market Capitalization	41MM
Cash	4MM
Long Term Debt	8MM
Enterprise Value (EV)	45MM
LT Debt/ Equity	0.16
BV/ Share	\$3.59
TTM Revenue	\$78MM
P/ Revenue	0.5x
TTM EPS	(0.29)
P/ EPS	NA
TTM EBITDA	335,000
EV/ EBITDA	NA

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