DFM Foods Limited

June 03, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	105.32 (Enhanced from 101.19)	CARE A; Negative (Single A; Outlook: Negative)	Reaffirmed
Short-term bank facilities	13.81 (Reduced from 17.94)	CARE A1 (A One)	Reaffirmed
Total bank facilities	**119.13** **(₹ One hundred nineteen crore and thirteen lakh only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The reaffirmation in the ratings assigned to the bank facilities of DFM Foods Limited (DFM) continues to derive strength from its experienced promoters and management team, its strong brand name leading to an established market position, its robust marketing and distribution network with continuous product innovation. The ratings also factor in the company's healthy cash and bank balance, liquid investments and negative operating cycle.

The ratings are, however, constrained by moderation in DFM's operating profitability during FY22 (refers to the period April 01 to March 31) due to increase in brand building, selling and marketing expenses, and the same are expected to continue in the medium term which will lead to subdued profitability at an operating level. The ratings are further constrained by DFM's geographical concentration in North India, susceptibility to raw material price fluctuations and competition in the packaged food market.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Significant growth in the total operating income (TOI) by 30%-35% along with improvement or sustenance in profit before interest, lease rentals, depreciation and taxation (PBILDT) margins at or more than 10%.
- Significant geographical diversification of sales leading to enhanced scale of operations.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Any increase in the debt-funded capex resulting in increase in the overall gearing by more than 0.8x on a sustained basis along with moderation in the liquidity position.
- Any decline in the scale of operations or deterioration in the market position.

Outlook: Negative

The outlook on the long-term ratings of DFM continues to remain 'Negative' on account of CARE Ratings Limited's (CARE Ratings') belief that the operating profitability of DFM will be moderated in medium term due to the increasing brand-building, selling and marketing expenses, which is in-line with the management's strategy of expanding its foothold in geographies outside North India as well as gaining market presence in the newer segments. Although the gross margins are being maintained, such sizeable expenditure is likely to constrain the accrual generation and liquidity position of DFM in the near to medium term. The revival in the operating margin or absolute PBILDT, backed by increase in the scale of operations is a monitorable for H1FY23. The outlook may be revised to 'Stable' in case DFM is able to reap long-term growth benefits derived out of such initiatives along with restoration of operating profitability to prior levels.

Key rating drivers

<u>Key rating strengths</u>

Experienced promoters and management team: DFM is held by AI Global Investments (Cyprus) PCC Limited, which holds 73.70% stake in the company. In September 2019, AIGIPL, which is a subsidiary of US-based private equity firm, Advent International Corporation (AIC), purchased stake from the erstwhile promoters. AIC employs a long-established strategy of operationally intensive, sector-focused investing across North America, Latin America, Europe and Asia. The group has a track record of over 360 private equity investments and includes deals ranging from all-equity and leveraged buyouts to growth equity investments, public-to-private transactions and recapitalisations. However, this is the first investment in the packaged food industry by the group.

Mr Lagan Shastri was appointed as the Managing Director and Chief Executive Officer of the company in January 2020. He is an alumnus of IIM Bangalore, who had majored in Marketing and Finance, and has over 21 years of experience in the fast moving consumer goods (FMCG) sector. Prior to joining the DFM, he worked as an Executive Director-Marketing Operations in Hindustan Coca-Cola Beverages Pvt. Ltd. The directors are being supported by qualified and experienced personnel at middle and lower levels of management, assisting them in the day-to-day operations. The company has also appointed a new CFO, Mr Nikhil Mathur

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

from July 01, 2021. He is a Chartered Accountant and MBA in Finance and Marketing from XLRI, Jamshedpur. He has 28 years of experience in leading businesses in the consumer products and technology sectors, viz., Asian Paints, Nokia and Microsoft.

Strong brand name leading to established market position: DFM markets its products under the flagship brand, 'CRAX', which has strong brand recognition in the snacks category in the country. DFM has invested continuously in brand building and marketing activities. CRAX – the company's brand for corn rings – was one of the earliest readymade snacks that was launched in India in 1984 and has established itself as a strong brand name over the years. The brand has high visibility on television, with a special focus on channels aimed at children, on-the-ground-presence and in-pack gifts. In the namkeen segment, DFM offers a complete range of products consisting of 18 distinct product variants that include bhujiya, daal, mixtures and nut-mixes. Furthermore, in FY22, DFM has entered the potato chips segment.

Legacy of successful product diversification: Until FY17 (refers to the period April 01 to March 31), DFM earned majority of its revenue from CRAX corn rings, which contributed around 80%-85% of its total income. The company had persisted with its product concentration in corn rings for more than three decades, since they had developed acceptance among the customers, especially with the age group of 6-10 years.
To reduce the concentration on CRAX corn rings, the company extended its product line through FY18 and FY19, by launching CRAX Curls in FY18, CRAX Fritts in Q3FY19 and CRAX Pasta Crunch in Q4FY19. The newly-launched product, 'Fritts', is a unique product in the market, targeted for all age groups and has been a successful step towards diversification of the portfolio. Even in the highly competitive market of 'Curls', DFM has been able to maintain its competitive edge over other players. Furthermore, in FY22, DFM entered into a new segment and launched potato chips in UP, Haryana and Uttarakhand, along with festive packs with higher price points. DFM also started higher price points of ₹25 for its existing products. These products helped in further exposing the company to diverse age groups and new segments.

Robust marketing and distribution network: The products of DFM are sold in India through distributor mode and retail mode. In the distributor mode, the products are sold directly to the distributors of the company spread across the country, which are directed onward to the retailer base. DFM is continuously increasing its distributor network in the country to increase its market reach. Currently, the company has its existence primarily in North India. As on April 30, 2022, DFM sold its products through a chain of 1,775 distributors spread across the country. Furthermore, the company is now venturing into e-commerce segment. DFM has also been planning to further increase its presence in the Tier-3 cities in northern India and this effort has been further aided and streamlined on the back of the pandemic, leading the public to prefer packaged foods over unpackaged. The same has also been increasingly contributing to the total revenues, which provides a healthy and growing base for diversification.

Comfortable financial risk profile: Despite the COVID-19-led lockdowns, DFM has reported 6% growth in its TOI in FY22 to reach ₹554.45 crore as against ₹524.06 crore in FY21. However, DFM reported PBILDT loss of ₹15.80 crore in FY22. The PBILDT levels declined largely due to increased investments in brand building and Go-to-Market expansion, technology and talent. These expenses increased to 12% of the TOI in FY22 as against 5% in FY21, to ₹65 crore in FY22 from ₹25 crore in FY21.
The PBILDT loss, interest and debt repayments totaling to ₹32.93 crore was funded out of the working capital borrowings and through cash and bank balance. Though the operating margins are exposed to the volatility in raw material prices, with continuous cost management initiatives with the new management, DFM has been able to maintain its gross margin in FY22 at around 37% despite a high inflationary environment.
The capital structure of the company moderated in FY22, however, remained comfortable with debt-to-equity ratio of 0.66x (PY: 0.72x) and overall gearing ratio of 0.79x (PY: 0.72x), as on March 31, 2022. The marginal moderation in the overall gearing is due to the reduction in networth on account of losses reported in FY22. As DFM reported loss (PBILDT and profit after tax [PAT] level) in FY22, other solvency indicators also moderated in FY22.

Strong liquidity: DFM operates in the ready-to-eat snacks business which is a low working capital intensive segment as demonstrated by its negative operating cycle during FY22 (PY: negative). The company majorly makes its sales on cash basis and therefore has minimal debtors. On the other hand, the inventory holding is around 20-25 days, whereas the credit period received is around 30-40 days, which results in a negative operating cycle.
The average fund-based working capital utilisation during the last 12 months ended April 2022 remained comfortable at around 39.71%, indicating the company has comfortable liquidity. Furthermore, the company has bank fixed deposits (FDs) and investments in mutual funds/debt funds of around ₹88.98 crore as on March 31, 2022. Against this, the company only has a repayment obligation of ₹12.31 crore in FY23.
As the company plans to increase its presence into newer territories, additional debt may be availed in the near to medium term. Nevertheless, the overall gearing is expected to remain within comfortable levels.

Industry outlook: The COVID-19 situation has led to strong demand for packaged foods, which is likely to continue in the near term. The long-term demand outlook is favourable on the expectations of increasing population, increase in per capita consumption, which in turn would be driven by changing lifestyles, growing urbanisation, and steadily rising affluence levels. Moreover, due to intense competition, the mid-sized players have limited flexibility over pricing its products, which also results in low to moderate profit margin. The business is also susceptible to changing preferences of consumers, etc. Furthermore, with increase in demand in rural areas with investments in rural infrastructure development, extension of farm credit provisions, and focus on job creation will trigger a consumption boom and boost growth momentum, which is showing strong signs of recovery with COVID-induced disruptions having eased out entirely.

Even though the pandemic hit the ready-to-eat snacks and namkeen segment significantly reducing production, demand, and profits, the long-term outlook remains positive supported by favourable dynamics in the country, such as changing lifestyle creating demand for new products, rising population, growing urbanisation, growing per capita income, and increasing penetration of technology. Furthermore, Indian packaged food (snacks) industry still has untapped segments and an underpenetrated rural market, which ensures growth prospects for the industry.
In such a scenario, DFM's prospects will be driven by its ability to scale up its operations by increasing its geographical presence, getting into new segments, and further improving its brand image.

Key rating weaknesses
Geographical concentration: DFM's revenue is concentrated in the northern region of the country from where it derives around 75%-80% of its revenue, with remaining from the east, west and southern geographies. However, the company has been improving its distribution network in other parts of the country and has witnessed growth in the revenue from other regions as well. The company is also planning to enter into Tier-3 northern regions to further expand its business reach. Furthermore, the company has been planning to reduce the same by its multi-product, multi-channel and multi-geography approach being adopted under the new management.

Susceptibility to cost fluctuations and high competition from other market players: The raw material costs formed a major part of the total expenses of the company at around 63% of the TOI in FY22 (PY: 59%). The main raw materials of the company are agro-based commodities, the prices of which are exposed to the vagaries of nature along with hoarding problems and lack of storage infrastructure. Moreover, the prices of these commodities are dependent upon various factors, including climatic conditions in the growing regions, substitutes for the crop (for farmers), government regulations, as well as alternate demand drivers. The operating margins are exposed to the volatility in raw material prices as its difficult for the company to immediately pass on any major price fluctuations in few of its raw materials, which are freely traded commodities like edible oil. Despite intense commodity inflation, DFM contained gross margins at 37% in FY22 through pricing improvement and a companywide cost management programme. Furthermore, the material margins (excluding portfolio expansion) improved to 39.1% in Q4FY22 compared with 38.1% in Q3FY22 (38.8% in Q2FY22).
Furthermore, the company remains exposed to high competition from larger established companies and small regional players, which have mushroomed across the country and have added to the competitive intensity of the industry. Hence, the biggest challenge for the industry players would be scaling up their regional presence to a national level while maintaining highest quality standards. DFM has moderate scale of operations, however, increasing but an established brand name enables DFM to have an edge over its competition.

Analytical approach
Standalone

Applicable criteria
Criteria on assigning 'outlook' and 'credit watch'
CARE Ratings' policy on Default Recognition
Rating methodology – Manufacturing companies
CARE Ratings' methodology for financial ratios (non-financial sector)
CARE Ratings' methodology for short-term instruments
Liquidity analysis of non-financial sector entities

About the company
DFM Foods Limited (DFM) was established in 1983 and is engaged in the business of manufacturing, selling and marketing of packaged foods. DFM's products profile consists of 18 distinct product variants (12 in namkeen segment and 6 in snacks segment). DFM markets its products under the flagship brand, 'CRAX', which has strong brand recognition in the snacks category in the country.
Initially, the company was promoted by The Delhi Flour Mills Company Limited (DFMCL), which held 32.55% stake in DFM. DFMCL is engaged in the business of flour milling and sells products primarily including maida, atta, suji, etc., which are sold under the brand name "Stag", while whole wheat atta under the name of "Kanak".
DFMCL, along with other investors, sold its stake in the company to AI Global Investments (Cyprus) PCC Limited (a subsidiary of US-based private equity firm Advent International Corporation (AIC)) in January 2020, which currently holds 73.70% of the equity shareholding of the company. AIC employs a long-established strategy of operationally intensive, sector-focused investing across North America, Latin America, Europe and Asia. The group has a track record of over 360 private equity investments, which includes deals ranging from all-equity and leveraged buyouts to growth equity investments, public-to-private transactions and recapitalisations.
The company had a total installed capacity (for both snacks and namkeen segment) of 48,400 MTPA per annum as on March 31, 2022. The installed capacity for the Snacks segment (corn rings, curls, cheese balls, Natkhat, Fritts and Pasta Crunch) is 45,400 MTPA and for Namkeen 3,000 MTPA.

Brief Financials (₹ crore)	FY21 (A)	FY22 (A)
TOI	524.06	554.45
PBILDT09	55.80	-15.80
PAT	28.70	-24.76

Overall gearing (times)	0.72	0.79
Interest coverage (times)	5.17	-ve

A: Audited

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

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

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3.

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term Loan		-	-	March 2027	61.22	CARE A; Negative
Non-fund-based - ST-BG/LC		-	-	-	13.81	CARE A1
Fund-based - LT-Cash Credit		-	-	-	44.10	CARE A; Negative

Annexure-2: Rating history of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) & Rating(s) assigned in 2022-2023	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	61.22	CARE A; Negative	-	1)CARE A; Negative (14-Feb-22) 2)CARE A; Stable (25-Nov-21) 3)CARE A; Stable (05-Nov-21)	1)CARE A; Stable (24-Nov-20)	1)CARE A; Stable (25-Feb-20) 2)CARE A (CWD) (18-Sep-19) 3)CARE A; Stable (05-Aug-19)
2	Non-fund-based - ST-BG/LC	ST	13.81	CARE A1	-	1)CARE A1 (14-Feb-22) 2)CARE A1 (25-Nov-21) 3)CARE A1 (05-Nov-21)	1)CARE A1 (24-Nov-20)	1)CARE A1 (25-Feb-20) 2)CARE A1 (CWD) (18-Sep-19) 3)CARE A1 (05-Aug-19)
3	Fund-based - LT-Cash Credit	LT	44.10	CARE A; Negative	-	1)CARE A; Negative (14-Feb-22) 2)CARE A; Stable (25-Nov-21) 3)CARE A; Stable (05-Nov-21)	1)CARE A; Stable (24-Nov-20)	1)CARE A; Stable (25-Feb-20) 2)CARE A (CWD) (18-Sep-19) 3)CARE A; Stable (05-Aug-19)

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities:

Name of the Instrument	Detailed Explanation
A. Financial covenants	
I. Current ratio	>=1.33 times
II. TOL/TNW	<=1.75
III. DSCR	>=2.00
B. Non-financial covenants	
I. Cashflows	All cashflows to be routed through the bank only
II. Availment of additional loans	No loan to be availed from any other banker without prior permission
III. Plant visit frequency	Quarterly

Annexure-4: Complexity level of various instruments rated for this company

Sr. No	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple
3	Non-fund-based - ST-BG/LC	Simple

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Annexure-5: Bank lender details for this company
To view the lender wise details of bank facilities please **click here**

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About CARE Ratings Limited:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has had a pivotal role to play in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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