# DFM Foods Limited

February 14, 2022

**Ratings**

| Facilities/Instruments | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Long Term Bank Facilities | 101.19 | CARE A; Negative (Single A; Outlook: Negative ) | Reaffirmed; Outlook revised from Stable |
| Short Term Bank Facilities | 17.94 | CARE A1 (A One ) | Reaffirmed |
| **Total Bank Facilities** | **119.13 (Rs. One Hundred Nineteen Crore and Thirteen Lakhs Only)** | | |

Details of instruments/facilities in Annexure-1

**Detailed Rationale & Key Rating Drivers**

The revision in outlook of DFM Foods Ltd (DFMFL) takes into account the moderation in operating profitability of the company in 9MFY22 (refers to period from April 01 to Dec 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 operating level. PBILDT margin have declined to 1.15% in 9MFY22 as against 13.80% in corresponding period during the previous year. The same is in-line with the management's strategy of expanding its foothold in geographies outside North India as well as gaining market presence in newer segments such as potato chips. Although, the gross margins are being maintained, such sizeable expenditure is likely to constrain the accrual generation and liquidity position of DFMFL in the near to medium term. The ability of the company to reap long-term growth benefits derived out of such initiatives along with restoration of operating profitability to prior levels going forward shall remain key rating monitorable.

The reaffirmation in the ratings assigned to the bank facilities 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 rating also factors in the company's comfortable financial risk profile marked by healthy cash and bank balance and liquid investments and low operating cycle.

The ratings, however, are constrained by DFMFL's geographical concentration in North India, susceptibility to raw material price fluctuations and competition in the packaged food market.

**Key Rating Sensitivities:**

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

- Significant growth in total operating income by 30%-35% along with improvement or sustenance in 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 decline in the scale of operations below Rs.500 cr
- Continued moderation in PBILDT margins below expected levels
- Any increase in debt funded capex resulting in increase in overall gearing by more than 0.8x on a sustained basis along with moderation in liquidity position.

**Detailed description of the key rating drivers**

**Key Rating Strengths**

**Experienced promoters and management team**

DFMFL is held by AI Global Investments (Cyprus) PCC Limited which holds 73.71% stake in the company. In Sept-2019, AIGIPL, which is a subsidiary of U.S.-based private equity firm, Advent International Corporation (AIC), purchased stake from 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 includes deals ranging from all-equity and leveraged buyouts to growth equity investments, public-to-private transactions and recapitalizations. 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 FMCG sector. Prior to joining the DFMFL, 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 day to day operations.

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

**Strong brand name leading to established market position**
DFMFL markets its products under the flagship brand '*CRAX*' which has strong brand recognition in the snacks category in the country. DFMFL 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 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, DFMFL offers a complete range of products consisting of 18 distinct product variants that include bhujiya, daal, mixtures and nut-mixes.

**Legacy of successful product diversification**
Until FY17 (refers to period from April 01 to March 31), DFMFL 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 customers, especially with the 6-10 years age group.
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 targeted for all age groups and is a unique product in the market and has been a successful step towards diversification of portfolio. Even in the highly competitive market of 'Curls', DFM has been able to maintain its competitive edge over other players. In FY21, the company introduced several new products including noodles, potato chips and corn bowls. These products helped in further exposing the company to diverse age groups and new segments.

**Robust marketing and distribution network**
The products of DFMFL are sold in India through distributor mode and retail mode. In the distributor mode, the products are sold directly to distributors of the company spread across the country which are directed onward to the retailer base. DFMFL 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 June 30, 2021; DFMFL sold its products through a chain of 1,486 distributors spread across the country. Further, the company is now venturing into e-commerce segment. The company 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 have also been increasingly contributing to the total revenues which provides a healthy and growing base for diversification.

**Comfortable financial risk profile**
In FY21, the total operating income increased marginally in FY21 to Rs.529.33 cr. from Rs.511.49 cr. in FY20 despite the COVID-led significant deterioration in the performance in Q1FY21. This was mainly on account of higher sales from some of the newly launched products like Fritts and Pasta Crunch. Further, the namkeen segment also witnessed a 51% increase in the sales in FY21.
The profitability margins were higher during the year marked by PBILDT margins of 11.54% and PAT margins of 5.42% (PY: 8.92% and 4.77%, respectively). The company reaped benefits of the cost saving measures undertaken in FY20 including better negotiation, automation of various processes, leading to improved efficiency and lesser errors, for the first complete year in FY21, which led to improvement in the margins. Furthermore, certain one-time expenses including appointment of new management, retirement benefits provided to several employees and PF settlements which dragged the margins down during the previous year were not incurred in FY21.
The capital structure of the company remained comfortable with debt-to-equity ratio of 0.72x (PY: 0.82x) and overall gearing ratio of 0.72x (PY: 0.86x), as on March 31, 2021. The improvement in the same was on account of scheduled term debt repayment, nil working capital utilization at the end of the year and accretion of profits to the net worth. Other solvency ratios of the company also remained comfortable with improvement in interest coverage to 11.54x times (PY: 8.92 times) in FY21 on account of improved profitability in FY21. The total debt to PBILDT ratio stood at 2.11 times (PY: 2.73 times) as on March 31, 2021.

*9MFY22 performance:* The total operating income of the company marginally increased to Rs.419 crore in 9MFY22 as compared to Rs.397 crore in 9MFY21. However, the PBILDT margin has dropped from 13.80% in to 1.15% during the period. The projected levels of profitability as guided by the management earlier for FY22 full year is not expected to be achieved and as guided by the management, they have firmed up the plans to invest heavily in various marketing initiatives. These expenses have increased from 3.4% of net sales i.e. Rs.14 cr in 9MFY21 to Rs.40 cr in 9MFY22 (i.e. ~9.8% of net sales). The investments in advertisement and Go-to-market initiatives, management's focus on multi-product, multi-channel and multi-geography approach would likely drive sustainable and profitable growth going ahead, albeit, constraining the operating margins in the near term.
This apart, the prices of agro based commodities like Palm oil, Corn Gritts, Suji, laminates, cartons etc, used as primary raw materials by the company have shot up in the past quarters, leading to higher raw material costs as well. Despite the commodity inflation, DFM contained gross margins at 37.1% in 9MFY22 through pricing improvement and a companywide cost management programme.

**Strong liquidity**
DFMFL operates in the ready-to-eat snacks business which is a low working capital intensive segment as demonstrated by its negative operating cycle during FY21 (PY: negative). The company makes all its sales on cash basis and therefore has nil 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 negative operating cycle.

The average fund based working capital utilization during the last 12 months ended August-2021 remained comfortable at ~52%. Furthermore, the company has free cash and bank balance of Rs.107 crore as on Dec 31, 2021 invested in form of bank fixed deposits and investment in mutual funds/ debt funds, against which the gross loan repayment in FY22 is Rs.10.40 crore. 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 favorable on the expectations of increasing population, increase in per capita consumption which in turn would be driven by changing lifestyles, growing urbanization, 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. Further, 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.
Due to Covid-19 outbreak, there was a gradual disruption in supply chain and due to the nation-wide lockdown, operations at multiple manufacturing, warehouses and office locations were temporarily shut or scaled down as per local guidelines from mid-March 2020 onwards. However, as restrictions on lockdown eased, operations gradually resumed and are now estimated to be at par with pre-Covid levels. During the complete lockdown time, FMCG players focused on restoring supply chains and getting required approvals from local authorities. Gradually, production ramped up and distribution improved. 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 urbanization, growing per capita income, and increasing penetration of technology. Further, 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**
DFMFL'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 revenue from other regions as well. The company is also planning to enter into Tier-3 northern regions to further expand its business reach. Further, 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 materials costs formed a major part of the total expenses of the company at ~59% of the total operating income in FY21. The main raw materials of the company are agro-based commodities, the prices of which are exposed to 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. Operating margins are exposed to volatility in raw material prices because of the inability of 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 37.9% through pricing improvement and a companywide cost management programme.
Further,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. DFMFL has moderate scale of operations however, increasing but an established brand name enables DFMFL to have an edge over its competition.

**Analytical approach:** Standalone

**Applicable Criteria**
**Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings**
**CARE's Policy on Default Recognition**
**Criteria for Short Term Instruments**
**Rating Methodology - Manufacturing Companies**
**Financial ratios - Non-Financial sector**
**Liquidity Analysis of Non-Financial Sector Entities**

**About the company**
DFM Foods Limited (DFMFL) was established in 1983 and is engaged in the business of manufacturing, selling and marketing of packaged foods. DFMFL's products profile consists of 18 distinct product variants (12 in namkeen segment and 6 in snacks segment). DFMFL 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 – CARE BBB+; Stable/ CARE A3+ as on Nov 19, 2020), which held 32.55% stake in DFMFL. 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 U.S.-based private equity firm Advent International Corporation (AIC)). in January 2020, which currently holds 73.71% 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 includes deals ranging from all-equity and leveraged buyouts to growth equity investments, public-to-private transactions and recapitalizations.
The company had a total installed capacity (for both snacks and namkeen segment) of 48,400 MTPA per annum as on March 31, 2021. The installed capacity for Snacks segment (Corn rings, curls, cheese balls, Natkhat, Fritts and Pasta Crunch) is 45,400 MTPA and for Namkeen 3,000 MTPA.

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

| Brief Financials (Rs. crore) | FY20 (A) | FY21 (A) | 9MFY22 (Prov.) |
|---|---|---|---|
| Total operating income | 511.49 | 529.33 | 419.20 |
| PBILDT | 45.62 | 61.07 | 4.81 |
| PAT | 24.42 | 28.70 | -9.93 |
| Overall gearing (times) | 0.86 | 0.72 | NA |
| Interest coverage (times) | 4.60 | 5.65 | 0.71 |

*A: Audited; Prov.: Provisional; NA: Not available*

**Status of non-cooperation with previous CRA: NA**

**Any other information:** NA

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

**Covenants of rated instrument / facility:** *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 (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|---|
| Fund-based - LT-Term Loan | | - | - | Mar-2027 | 66.69 | CARE A; Negative |
| Non-fund-based - ST-BG/LC | | - | - | - | 17.94 | CARE A1 |
| Fund-based - LT-Cash Credit | | - | - | - | 34.50 | 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 (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2021-2022 | Date(s) & Rating(s) assigned in 2020-2021 | Date(s) & Rating(s) assigned in 2019-2020 | Date(s) & Rating(s) assigned in 2018-2019 |
| 1 | Fund-based - LT-Term Loan | LT | 66.69 | CARE A; Negative | 1)CARE A; Stable (25-Nov-21)<br><br>2)CARE A; Stable (05-Nov-21) | 1)CARE A; Stable (24-Nov-20) | 1)CARE A; Stable (25-Feb-20)<br><br>2)CARE A (CWD) (18-Sep-19)<br><br>3)CARE A; Stable (05-Aug-19) | 1)CARE A; Stable (17-Dec-18) |
| 2 | Non-fund-based - ST-BG/LC | ST | 17.94 | CARE A1 | 1)CARE A1 (25-Nov-21)<br><br>2)CARE A1 (05-Nov-21) | 1)CARE A1 (24-Nov-20) | 1)CARE A1 (25-Feb-20)<br><br>2)CARE A1 (CWD) (18-Sep-19)<br><br>3)CARE A1 (05-Aug-19) | 1)CARE A1 (17-Dec-18) |
| 3 | Fund-based - LT-Cash Credit | LT | 34.50 | CARE A; Negative | 1)CARE A; Stable (25-Nov-21)<br><br>2)CARE A; Stable (05-Nov-21) | 1)CARE A; Stable (24-Nov-20) | 1)CARE A; Stable (25-Feb-20)<br><br>2)CARE A (CWD) (18-Sep-19)<br><br>3)CARE A; Stable (05-Aug-19) | 1)CARE A; Stable (17-Dec-18) |

* Long Term / Short Term

**Annexure-3: Detailed explanation of covenants of the rated instrument / 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 |

**Annexure 5: Bank Lender Details for this Company**

To view the lender wise details of bank facilities please click here

**Note on complexity levels of the rated instrument:** CARE Ratings Ltd. 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.

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With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.



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