DFM Foods Limited

September 12, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	86.26 (Reduced from 105.32)	CARE BBB+; Stable	Reaffirmed
Long-term/Short-term bank facilities	20.00 (Enhanced from 13.81)	CARE BBB+; Stable/CARE A2	Revised from CARE A2

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has reaffirmed the ratings of the bank facilities of DFM Foods Limited (DFM). The rating assessment continues to derive its strength from DFM's established brand name, market position, and its stronghold over the Northern region of the country, supported by its wide distribution network. Furthermore, the company has a comfortable capital structure, supported by efficient working capital management.

These rating strengths are partially tempered by the geographical concentration risk, leading to moderate scale of operations, and its margins being susceptible due to cost fluctuations and intense competition. Over the last two fiscals through FY23, the company's high growth strategy through incurring significant marketing expenses towards brand building and go-to-market expenses along with high employee costs led to operational losses, and thus, weak debt coverage metrics and significant moderation in liquidity. However, CARE Ratings has noted the management's decision to curb marketing expenses, which was reflected in Q1FY24, and thus, expects the company to generate cash accruals of about ₹22-24 crore in FY24. Any deviation from the current path to profitability is a key monitorable considering no equity infusion is expected.

Furthermore, CARE Ratings has noted the Delisting Public Announcement on March 16, 2023, by the company in relation to voluntary delisting of the equity shares of the company from the Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE) in compliance with the provisions of the Securities and Exchange Board of India (SEBI) (Delisting of Equity Shares) Regulations, 2021 ('Delisting Regulations'). The company got delisted on the stock exchanges with effect from April 5, 2023.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors:

- Substantial rise in gross cash accruals (GCA) with increase in scale of operations and/or improvement in profitability to more than ₹50 crore on a sustained basis.
- Improvement in profitability, leading to strengthening of the debt coverage metrics with profit before interest, lease rentals, depreciation, and taxation (PBILDT) interest coverage at least 3x and total debt (TD) to GCA of maximum 4x sustainably.
- Significant equity infusion covering the losses and strengthening the overall gearing to below 0.25x on a sustained basis.

Negative factors:

- Any debt-funded programme in the short term, resulting in an increase in the overall gearing by more than 0.80x on a sustained basis along with moderation in the liquidity position.
- Any deviation in the path to profitable operations in the medium term from the current expectations.
- Any decline in the scale of operations or deterioration in the market position.

Analytical approach: Standalone

Outlook: Stable

The 'Stable' outlook signifies that the entity is likely to maintain its brand presence in the extruded packaged foods segment, which, coupled with the stable demand scenario, will enable it to sustain its scale of operations. The company is expected to operate at modest profitability with a cut in its marketing expenses and may continue to maintain its adequate liquidity.

Detailed description of the key rating drivers

Key strengths

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

Strong brand name with an established market position in Northern India and wide distribution network
DFM introduced 'CRAX' (the company's flagship brand) in 1984, and with continued branding and marketing efforts, has established itself as a strong brand name in the Indian snacks segment for over three decades. The company enjoys a high brand recall value, offering more than 21 distinct products in the snacks and *namkeen* segment. Initially, DFM focused on the children's market with its flagship product, Crax Rings, and a well-executed strategy of including in-pack gifts. However, the company has strategically diversified its product portfolio over time to reduce its dependence on this segment and cater to a wider demographic. This diversification includes the introduction of *namkeen* and, more recently in FY22, chips, marking a shift towards a broader customer base. In FY23, it further expanded its product portfolio to launch Crax Pipes and added variations to its existing products. This expansion strategy is a testament to DFM's commitment to leveraging its established brand and consolidating its market position. It has a demonstrated presence in Northern India and is actively pursuing expansion efforts in the East zone with a distribution network of more than 1,200 distributors pan-India.

Comfortable capital structure supported by efficient working capital management
In FY23, on account of losses incurred due to sustained advertising and global trade management (GTM) expenses, the capital structure of the company moderated yet remained comfortable, supported by DFM's efficient operational cycle. The company held an average of 26 days of inventory, collected payments within an average of four days, and had an average creditor period of 47 days, resulting in a negative operating cycle of 18 days. This efficient model allowed them to collect cash and settle supplier payments before needing to pay for inventory, providing a notable financial cushion against a falling net worth from the operating losses. As on March 31, 2023, the debt-to-equity ratio stood at 0.80x (PY: 0.66x) and the overall gearing ratio stood at 0.98x (PY: 0.79x). CARE Ratings expects the debt coverage matrix to improve in FY24, as the management curtails its expenditure and gain benefits from the expenses incurred.

Key weaknesses
Geographical concentration risk, leading to moderate scale of operations
DFM predominantly derives 78-80% of its revenue from the Northern region of the country, followed by the Eastern, Western, and Southern regions. This has led to its scale of operations remaining moderate with a total operating income (TOI) of ₹586.08 crore in FY23 (FY22: ₹554.45 crore), despite incurring significant marketing expenses over the last two fiscal years through FY22. However, in August 2023, the company commercialised a new manufacturing plant in the East zone with an installed capacity of 5,100 metric tonne per annum (MTPA), exhibiting favourable potential for increased revenue from this region. Furthermore, the company is strategically reducing its dependence on any single region and product by adopting a multi-product, multi-channel, and multi-geography approach under its new management.

Susceptible operating margins due to cost fluctuations and intense competitive
The primary raw materials (palm oil, corn grit, suji, and packaging materials) constitute more than 60% of the total costs. The pricing of these materials is influenced by various factors, including geographical and climatic conditions, global market prices, and domestic supply and demand dynamics. Consequently, the company's profitability is susceptible to fluctuations in raw material prices and inflationary pressures. However, DFM has been able to maintain a gross margin of 36-40% in the last five years through FY23, attributed to the company's brand equity, the implementation of various cost-control measures, and through pricing improvement. The company improved its gross margin from 36% in FY22 to 38% in FY23.

The company also faces significant competition from both, well-established large companies and emerging small regional players that have proliferated nationwide, intensifying competition within the industry. Although DFM operates at a moderate scale, having an established brand name positions DFM favourably in comparison to its competitors.

Weak debt coverage ratios on account of operational losses
In FY22 and FY23, the company's capital structure moderated due to continued spending on marketing expenses to support high turnover growth strategy. These expenditures did not yield the expected revenue levels, resulting in losses at both, the PBILDT and profit-after-tax (PAT) levels, resulting in weak debt coverage metrics, i.e., interest coverage and TD to GCA. However, these ratios may improve gradually, considering reverting the marketing expenses to about 6% of the TOI as observed in the past before FY22. The interest coverage is estimated to be around 4x in FY24 and TD to GCA to be around 3x. Considering no significant incremental debt and scheduled term loan repayments over FY24 and FY25, the coverage ratios may further improve FY25 onwards.

Liquidity: Adequate
The liquidity position of DFM is adequate, as marked by adequate combination of GCA and cash and bank balance for FY24 against its repayment obligations. The turnaround in the company's marketing strategy has induced the company to generate profits in Q1FY24, resulting in positive cash accruals of ₹3.10 crore. It is expected that the company will generate at least ₹20 crore GCA in FY24. As on June 30, 2023, the company held ₹22.06 crore in free cash and cash equivalents, ensuring a comfortable liquidity

position. Furthermore, an additional ₹1.9 crore in margin money will become free in Q2FY24. Against this, the company has outstanding repayment obligations of ₹11.31 crore for FY24 (excluding Q1FY24). The GCA is expected to further ramp up to about ₹59.28 crore in FY25 against repayment obligations of ₹22.16 crore. In FY23, the company utilised 63% and 42% of its working capital limits comprising cash credit (CC) plus overdraft (OD) and bill discounting limits, respectively. The company's negative working capital cycle further enhances its cash flow generation capabilities, as it expands its operations but constrains its current ratio, which was at 0.64x, and quick ratio at 0.45x in FY23.

Applicable criteria

Policy on default recognition
Rating Methodology – Manufacturing Companies
Financial ratios – Non-Financial Sector
Criteria for Short-term Instruments
Liquidity Analysis of Non-Financial Sector Entities
Rating Outlook and Credit Watch
Policy on Withdrawal of Ratings

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Fast Moving Consumer Goods	Fast Moving Consumer Goods	Food Products	Other Food Products

DFM was established in 1983 and is engaged in the business of manufacturing, distributing, and marketing packaged foods. As on August 30, 2023, the company's total installed capacity is 57,000 MTPA, including the capacity added by the Kolkata plant (5,100 MTPA). The installed capacity for the snacks segment is 54,000 MTPA, whereas the installed capacity for *namkeen* is 3,000 MTPA. DFM is currently promoted by Advent International – a global private equity (PE) firm. The company, post a public announcement in March 2023, got delisted from the stock exchanges with effect from April 05, and Advent International increased its shareholding to 94.81% (from 78.7% as on December 2022).

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (UA)	Q1FY24 (UA)
Total operating income	554.45	586.08	123.40
PBILDT	-15.22	-34.15	5.40
PAT	-24.76	-61.38	-0.20
Overall gearing (times)	0.78	0.98	-
Interest coverage (times)	-1.71	-3.77	14.99

A: Audited; UA: Unaudited. Note: The above results are the latest financial results available.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

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

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

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term Loan		-	-	31-03-2027	51.26	CARE BBB+; Stable
Fund-based - LT-Working Capital Limits		-	-	-	35.00	CARE BBB+; Stable
Fund-based/Non-fund-based-LT/ST		-	-	-	20.00	CARE BBB+; Stable / CARE A2

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Fund-based - LT-Term Loan	LT	51.26	CARE BBB+; Stable	-	1)CARE BBB+; Stable (23-Dec-22) 2)CARE A; Negative (03-Jun-22)	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)
2	Fund-based/Non-fund-based-LT/ST	LT/ST*	20.00	CARE BBB+; Stable / CARE A2	-	1)CARE A2 (23-Dec-22) 2)CARE A1 (03-Jun-22)	1)CARE A1 (14-Feb-22) 2)CARE A1 (25-Nov-21) 3)CARE A1 (05-Nov-21)	1)CARE A1 (24-Nov-20)

3	Fund-based - LT-Working Capital Limits	LT	35.00	CARE BBB+; Stable	-	1)CARE BBB+; Stable (23-Dec-22) 2)CARE A; Negative (03-Jun-22)	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)

*Long term/Short term.

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

Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Term Loan	Simple
2	Fund-based - LT-Working Capital Limits	Simple
3	Fund-based/Non-fund-based-LT/ST	Simple

Annexure-5: Lender details

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

Note on the 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.

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About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. 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 played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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