DFM Foods Limited (Revised)

December 23, 2022

Rating/Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	105.32	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Revised from CARE A; Negative (Single A; Outlook: Negative)
Short Term Bank Facilities	13.81	CARE A2 (A Two)	Revised from CARE A1 (A One)
Total Bank Facilities	**119.13 (₹ One Hundred Nineteen Crore and Thirteen Lakhs Only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has revised its ratings on the bank facilities of DFM Foods Ltd (DFM) from 'CARE A; Negative/CARE A1' to 'CARE BBB+; Stable/CARE A2'. The rating revision reflects deterioration in the credit metrics of the company on account of losses from higher operational expenditure which is expected to continue over the near to medium term. The company is strategically placing itself on the path to expanding its foothold in geographies outside North India as well as gaining market presence in the newer segments. However, this entails substantial incremental marketing expenses towards brand building and go-to-market (GTM) expansion along with higher employee costs leading to losses, both at PBILDT and PAT level. The gradual erosion of the networth in FY22 and H1FY23 has moderated the leverage ratio. The company's cash and cash equivalents have also moderated over H1FY23 on account of cash losses. The company is expected to incur losses over the near to medium term depending upon the extent of scalability of operations which would be key monitorable along with its impact on the company's financial flexibility.

The ratings, however, continue to derive its strength from its experienced promoters and management team, strong brand name leading to an established market position, robust marketing and distribution network with continuous product innovation. Despite the losses, the company continues to have healthy capital structure as well.

Further, CARE Ratings has noted the announcement on December 2, 2022 by the company of order received from the Joint Commissioner, Central GST, Ghaziabad wherein the quantum of claims is recovery of non-payment of differential GST amounting to ₹101 crore approximately along with applicable interest and penalty of ₹25000 on Chief Financial Officer. The Directorate General of GST Intelligence has alleged that DFM has been misclassifying its products which the management of the company has contested basis advice from one of the leading tax counsels in the country as DFM follows the same classification similar to its peers. The company, hence, would be preferring an appeal against the aforesaid order. Also, CARE Ratings had taken note of the ongoing delisting process of equity shares of the company from BSE and NSE.

Rating sensitivities

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

- Substantial rise in gross cash accruals with increase in scale of operations and/or improvement in profitability to more than Rs.45 crore on a sustained basis
- Improvement in profitability leading to strengthening of debt coverage metrics with PBILDT interest coverage atleast 3x and total debt 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 – Factors that could lead to negative rating action/downgrade:

- Significant dip in cash & cash equivalents leading to subdued liquidity
- Losses leading to deterioration in capital structure with overall gearing weakening to 1.50x or more

Detailed description of the key rating drivers

Key rating strengths

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

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

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 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 has started focussing higher price points products i.e. more than Rs.5. These initiatives in FY22 along with normalized Q1FY23 have helped the company to grow its net sales in H1FY23 to Rs.311 crore with growth of 20.69% year on year (Y-o-Y). 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 capital structure despite losses: The company's strategic plan towards market share growth through brand building and GTM expenses along with other incremental expenses has led to losses in FY22 and H1FY23. Yet, the company has moderate networth of ₹148.65 crore (₹177.91) as on March 31, 2022 (2021) and ₹129.52 crore as on September 30, 2022. Further, the overall gearing though moderated is yet comfortable at 0.79x (0.72x) as on March 31, 2022 (2021) and 0.86x as on September 30, 2022. Though this may remain under pressure over the medium term, however the efficient management of working capital cycle reduces debt usage in case of incremental scale of operations. Hence, going forward, the capital structure may weaken further from current levels, yet is expected to remain comfortable.

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

company-wide cost management programme. Furthermore, the gross margins improved to 38.29% in H1Y23 against 36.89% in H1FY22 on account of moderation in raw material prices. However, this doesn't fully offset the increased operational expenditure.
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. An established brand name enables DFM to have an edge over its competition.

Weak debt coverage ratios on account of operational losses: The operational losses have meant that the company temporarily may not be able to service its debt obligations through internal accruals. However, the company has adequate cash & cash equivalents to manage these obligations over the medium term.

Liquidity: Adequate

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 company's working capital limit utilization was 64% in September 2022 while the free cash & cash equivalents of ₹54.6 crore as on September 30, 2022 which keeps the liquidity position comfortable. The free cash & cash equivalents as well as unutilized working capital limits may moderate further in case of continued cash losses, however, the extent of this will be key monitorable. Against this, the company only has a repayment obligation of ₹4.9 crore in FY23 while it grows to ₹18.35 crore in FY24.

Analytical approach: Standalone

Applicable criteria

Policy on default recognition
Financial Ratios – Non financial Sector
Manufacturing Companies
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Policy on Withdrawal of Ratings

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)	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23 (UA)
Total operating income	529.33	554.45	312.92
PBILDT	61.07	-17.09	-23.43
PAT	28.70	-24.76	-26.44
Overall gearing (times)	0.72	0.77	0.86
Interest coverage (times)	5.65	-ve	-ve

A: Audited; UA; -ve: Negative

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: Not Applicable

Complexity level of various instruments rated for this company: Annexure-3

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-Cash Credit	-	-	-	-	44.10	CARE BBB+; Stable
Fund-based - LT-Term Loan	-	-	-	31-03-2027	61.22	CARE BBB+; Stable
Non-fund-based - ST-BG/LC	-	-	-	-	13.81	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 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	61.22	CARE BBB+; Stable	1)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)	1)CARE A; Stable (25-Feb-20) 2)CARE A (CW with Developing Implications) (18-Sep-19) 3)CARE A; Stable (05-Aug-19)
2	Non-fund-based - ST-BG/LC	ST	13.81	CARE A2	1)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)	1)CARE A1 (25-Feb-20) 2)CARE A1 (CW with Developing Implications) (18-Sep-19) 3)CARE A1 (05-Aug-19)
3	Fund-based - LT-Cash Credit	LT	44.10	CARE BBB+; Stable	1)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)	1)CARE A; Stable (25-Feb-20) 2)CARE A (CW with Developing Implications) (18-Sep-19) 3)CARE A; Stable (05-Aug-19)

*Long term/Short term.

Annexure-3: 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-4: 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 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.

Contact us

Media contact
Name: Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact
Name: Ravleen Sethi
Phone: 9818032229
E-mail: ravleen.sethi@careedge.in

Relationship contact
Name: Swati Agrawal
Phone: +91-11-4533 3200
E-mail: swati.agrawal@careedge.in

About us:
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