DFM Foods Limited

November 24, 2020

Ratings

Facilities*	Amount (Rs. crore)	Rating	Rating Action
Long Term Bank Facilities	85.79 (Reduced from 96.06)	**CARE A; Stable (Single A; Outlook: Stable)**	**Reaffirmed**
Short Term Bank Facilities	16.33	**CARE A1 (A One)**	**Reaffirmed**
Total Bank Facilities	**102.12 (Rs. One Hundred Two Crore and Twelve Lakhs Only)**		

Details in Annexure I

Detailed Rationale & Key Rating Drivers

The reaffirmation in the ratings assigned to the bank facilities of DFM Foods Limited (DFMFL) 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 along with successful commissioning of its new line at their Greater Noida plant. The rating also factors in the company's comfortable financial risk profile marked by healthy cash and bank balance and liquid investments, and a 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.

Going forward, the company's ability to expand its scale of operations through new product launches and to diversify its operations to other geographies while maintaining its profitability and capital structure would remain the key rating sensitivities.

Key Rating Sensitivities:

Positive factors

- Significant growth in total operating income along with improvement in PBILDT margins to more than 20% on a sustained basis.
- Improvement in total debt/GCA to below 2.0x, and sustenance at such levels.

Negative factors

- Any increase in debt funded capex resulting in increase in overall gearing by more than 1.0x on a sustained basis.
- Any decline in the PBILDT margin below 8%.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and management team

On September 09, 2019, the erstwhile promoters of the Company entered into Share Purchase Agreement ("SPA") with AI Global Investments (Cyprus) PCC Limited ('the Purchaser') to sell its shareholding, subject to completion of the open offer made under the SEBI (Substantial Acquisition of Shares and Takeovers Regulations, 2011) and conditions precedent to SPA. Pursuant to SPA, the shareholding has been transferred and AIGIPL currently holds 73.94% of the equity shareholding of the Company. AI Global Investments (Cyprus) PCC Ltd. is a subsidiary of U.S.-based private equity firm, Advent International Corporation (AIC). 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.

Strong brand name leading to established market position

DFMFL markets its products under the brand names *CRAX* and *NATKHAT* which have strong 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, 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 launch of 'CRAX FRITTS' was huge success which generated revenue of Rs. 39.14 crore in the first year itself (accounting for 7.89% of the Total revenue in FY19). The product contributed revenue of Rs. 66.41 crore in FY20 (accounting for 12.58% of the total revenue in FY20). *CRAX* Pasta Crunch was launched in March 2019 and it generated revenue of Rs. 14.87 crore in FY20 (PY: Rs. 1.43 crore).In FY20, two new flavour variants to Fritts were added – Red Chilli Chatka and Noodle Masala. With the recent change in the management, the company is focussing further on diversifying its operations by adding new products.

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 Tier-I and Tier-II cities in North India. As on June 30, 2020; DFMFL sold its products through a chain of 1,336 distributors spread across the country. Further, the company is now venturing into e-commerce segment.

Comfortable financial risk profile, despite increase in gearing

In FY20, the total operating income of the company increased by 5.10% to Rs. 511.49 crore (PY: Rs. 486.66 crore) due to increase in volumes sold. In addition, *CRAX* Fritts, which was launched in Q3FY19, contributed a revenue of Rs. 66.41 crore (accounting for 12.58% of the total Revenue in FY20) vis-à-vis Rs. 39.14 crore in FY19.

However, the PBILDT margin of the company moderated to 8.92% in FY20 from 13.42% in FY19, primarily on account of some onetime expenses incurred by the company of around Rs. 12.61 crore which include transaction related cost for change in ownership, appointment of new management, retirement benefits provided to several employees, and provident fund settlements. Also, with the outbreak of Covid-19 the Q4FY20 was impacted due to closure of factories and inventory loss of around Rs. 3.05 crore was booked, due to perishable nature of the products.

The overall gearing of the company marginally increased to 0.86x as on March 31, 2020 on account of increase in debt in the form of lease liabilities of Rs. 30.21 crore in FY20 (PY: NIL). The other debt coverage indicators also moderated in FY20 on account of muted financial performance. The total debt / GCA and interest coverage ratio declined to 4.07x (PY: 2.04x) and 4.60x (PY: 6.26x) respectively. The total debt of the company as on March 31, 2020 stood at Rs. 124.40 crore (including term loans of Rs. 89.51 crore, lease liabilities of Rs. 30.21 crore, and working capital borrowings of Rs. 4.68 crore).

H1FY21 performance: The company witnessed moderation of 2% in its total operating income to Rs. 259.95 crore in H1FY21 as compared with Rs. 266.18 crore in H1FY20 on account of subdued demand amid the Covid-19 pandemic. However, the PBILDT and PAT margins have increased marginally in H1FY21 on account of promoter and management change which has brought in better negotiation and cost management strategies. The company had term loans amounting to Rs. 86.21 crore outstanding as on September 30, 2020.

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 FY20 (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 negligible/negative operating cycle.

The average working capital utilization during the last 12 months ended June 2020 remained comfortable at 45.54%. Furthermore, the company has total cash and bank balance of Rs. 122.33 crore (free cash and bank balance of Rs. 113.85 and Rs. 8.49 crore lien marked) as on September 30, 2020, against which the gross loan repayment in FY21 is Rs. 6.87 crore. Further, the current working capital utilization is nil (company has limits of Rs. 11.50 crore) which provides additional liquidity buffer. The company's cash & bank balance stood at Rs. 33.94 crore and current investments (in debt mutual funds) stood at Rs. 57.82 crore as on March 31, 2020. DFMFL had also availed moratorium for two months (April & May 2020) as a cautionary measure the same was approved by the banks. The cumulative interest component was paid by the company in June 2020.

Completion of new line addition at Greater Noida plant
With effect from Oct 17, 2019, the company has commissioned additional line having a capacity of 5000 MT per annum in Greater Noida. With this expansion, the company has two manufacturing facilities in Uttar Pradesh (Ghaziabad and Greater Noida) with the total capacity of the company at 48,400 M.T. per annum (PY: 39,400 MT). The cost of this expansion was around Rs. 18 crore which was funded through internal accruals only. Under line up-gradation, the old line (which produces 300kg/hour) was replaced with a new line (which produces 500 kg/hour) which resulted in an additional production of 200kg/hour. The additional capacity was utilized in the production of *CRAX* Fritts.

Industry Outlook
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. Transportation of goods was the main constraint as large number of workers migrated to their villages creating shortage of truck drivers and loading/un-loading staff. Further, state borders were sealed and ports were not operating at full levels. Though the government permitted movement and delivery of essentials goods, accessibility remained a challenge and logistics became inefficient. Reportedly, the daily movement of trucks decreased to less than 10% of normal levels in initial days of lockdown. This led to difficulties in raw materials sourcing and therefore, various manufacturing units of FMCG players witnessed a sudden fall in capacity utilization of below 50%. With this, finished goods inventory levels at both the distributors as well as retailers drastically reduced by March end. This created widespread fears among end-use consumers and panic buying. However, as restrictions on lockdown eased, operations gradually resumed and are now estimated to be at par with pre-Covid levels. During that time, FMCG players focused on restoring supply chains and getting required approvals from local authorities. Gradually, production ramped up and distribution improved. By mid-May, FMCG players were operating at 70-75% capacity utilization levels, varying depending on the number of distributors and the outlets in the red, orange or green zones. 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 under-penetrated rural market which ensures growth prospects for the industry.

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. During H1FY21 it garnered around 79% to the total revenue (PY: 78%) from North India (primarily in Tier-I & Tier-II cities). 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 is also looking at expanding its presence in other regions as well.

High competition from other market players
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). The company markets Corn Rings and Wheat Puffs under the 'CRAX' and 'NATKHAT' brand names. Initially, the company was promoted by The Delhi Flour Mills Company Limited (DFMCL – CARE BBB-; Credit Watch / CARE A3; Credit Watch as on April 06, 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 73.94% 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, 2020. 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)	FY19 (A)	FY20 (A)
Income from Operations	486.66	511.49
PBILDT	66.56	45.62
PAT	32.76	24.42
Overall gearing (times)	0.75	0.86
Interest Coverage	6.26	4.60

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History: Please refer Annexure-2

Annexure-1: **Details of Instruments/Facilities**

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	Sept 2027*	74.29	CARE A; Stable
Non-fund-based - ST-BG/LC	-	-	-	16.33	CARE A1
Fund-based - LT-Cash Credit	-	-	-	11.50	CARE A; Stable

* The company has multiple term loans. The given maturity date is the date of the last term loan.

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	74.29	CARE A; Stable	-	1)CARE A; Stable (25-Feb-20) 2)CARE A (Under Credit watch with Developing Implications) (18-Sep-19) 3)CARE A; Stable (05-Aug-19)	1)CARE A; Stable (17-Dec-18)	1)CARE A; Stable (05-Oct-17)
2.	Non-fund-based - ST-BG/LC	ST	16.33	CARE A1	-	1)CARE A1 (25-Feb-20) 2)CARE A1 (Under Credit watch with Developing Implications) (18-Sep-19) 3)CARE A1 (05-Aug-19)	1)CARE A1 (17-Dec-18)	1)CARE A1 (05-Oct-17)
3.	Fund-based - LT-Cash Credit	LT	11.50	CARE A; Stable	-	1)CARE A; Stable (25-Feb-20) 2)CARE A (Under Credit watch with Developing Implications) (18-Sep-19) 3)CARE A; Stable (05-Aug-19)	1)CARE A; Stable (17-Dec-18)	1)CARE A; Stable (05-Oct-17)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: Not Applicable

Annexure 4: Complexity level of various instruments rated for this Company

Sr. No.	Name of the 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 instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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