DFM Foods (BSE Code: 519588) – Alpha/Alpha + stock recommendation for Apr'15

Content Index

Company Snapshot (19th Apr'15)

BSE CMP – 322.00 **Dividend yield** – 0.77%

BSE Code – 519588

Market capitalization – Rs 322.05 cr. **Total Equity shares** – 1.00 cr.

Face Value – Rs 10.00 **52 Weeks High/Low** – Rs 425.00/227.00

Particulars (in cr.)	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14
	Before discontinuation of wheat trading			Post discontinuation of wheat trading business				
Snacks food Production (in MT)	2413	2895	3605	4567	6565	9328	11853	13058
Income from operations (Snacks Food)	23.88	31.66	53.34	72.19	119.98	169.42	225.24	263.25
Total Cost of Goods sold				43.77	76.31	107.97	142.65	165.09
Gross profit				28.42	43.67	61.45	82.59	98.16
Gross Profit margin (%)				39.37%	36.40%	36.27%	36.67%	37.29%
EBITDA				7.36	14.89	20.00	21.02	22.64
EBITDA margin (%)				10.20%	12.41%	11.80%	9.33%	8.60%
Other Income								
Div/interest/exchange variation				1.28	1.4	2.77	2.82	3.88
Depreciation				-0.97	-1.41	-2.38	-4.38	-5.79
Interest				-1.32	-2.17	-4.47	-9.42	-8.49
PBT	0.17	1.99	6.17	6.35	12.71	15.92	10.04	12.24
Adjusted PAT	0.11	1.32	4.09	4.21	8.32	10.36	6.31	8.08
Net Reported PAT		0.78	2.00	4.21	8.32	10.36	6.31	7.10
ROAE	0.81%	10.14%	30.23%	27.73%	42.55%	39.21%	19.81%	22.67%
Cash flows from operations				14.85	12.08	13.01	12.98	11.57
Net debt	2.01	25.05	6.77	5.38	8.01	57.29	63.36	33.84

Introduction

DFM Foods is the company behind the well-known CRAX corn rings. The company is engaged in the business of manufacturing, selling and marketing of packaged snack foods and pioneered the entry of packaged snacks in the Indian market with the introduction of Crax Corn Rings product. Corn Rings and Wheat Puffs are marketed under the CRAX and NATKHAT brand names respectively.

DFM's products are focused primarily on ready-to-eat snacks for children. Corn Rings sold under CRAX brand remains the company's main product, contributing ~75-80% to revenues and 10-11% contribution each from NATKHAT and Namkeens.

Differentiated product positioning and pricing – CRAX corn rings command leadership position in the roasted corn snacks segment and cater largely to the ready to eat snacks demand of children in the age group of 6-14 years.

In fact, company has priced CRAX corn rings at Rs 5/10 per pack and NATKHAT at Rs 2/5 per pack and offers free gifts with every pack to lure in children. The company focuses its promotional activities on children and runs its advertisements on cartoon based channels.

Going forward, DFM plans to leverage the CRAX brand by launching it across a wider product range and age group outside the current target group.

Geographical expansion – DFM sells its products primarily across North and Central India, however since the last 2-3 years it has been expanding in West and East India as well and the two regions now contribute 15% to the sales of the company against 0% three-four years back.

The company's focus is on penetration of existing markets and gradual expansion into unchartered territories as there's huge score for expansion of distribution network and leverage the brand equity of CRAX.

Industry Outlook – The total market for salty snacks in India is worth Rs 13,000 crore. The Ready-to-eat snacks market is growing at ~15% p.a. and ~40-45% of the market for salty snacks is unregulated, thus offering huge scope for DFM to grow consistently and expand its market share over the foreseeable future.

As per the latest report by CRISIL, Tier-2 FMCG players have increased their share in the domestic Food and Beverages (F&B) market to 30% from 20%, and grown at nearly twice the pace of Tier-1 players. Further, the report suggests that Tier-2 players will increase their market share to 40% by 2019.

Performance – DFM's performance has been excellent over the last 5 and 10 years cycles. The company has consistently delivered sales and profits growth in excess of 25% and has also maintained return on investments in the range of 22-25%.

DFM's working capital requirement is zero (even negative) as the company sells its product on cash and maintains very low level of inventory which is more than covered by the payables and the advances from the customers. The same also results in very strong cash flows from operations.

In 2012-13 the company expanded its capacity from ~6500 tonnes per annum to around 16,500 tonnes per annum and the current capacity utilization is ~75%. The 75 crores CAPEX was funded through a mix of internal accruals and debt and impacted the profitability of the company in the last 2 years on account of both higher interest and depreciation charges, however the company now has only about 10 crores of net debt and with gradual scale up in utilization we expect improvement in margins and profitability on both EBITDA and net profit level.

Also, no major CAPEX is expected for the next 12-18 months, while a brownfield expansion at the existing facility can be funded through internal accruals and shall result in additional capacity of around 5000 tonnes.

For FY 16, assuming very modest growth of 15-18% (over the last 3, 5 and 10 years cycles the company has consistently recorded 20% growth) and EBITDA margins of 9.6-10%, we expect the company to record pre-tax earnings of 22-23.50 crores.

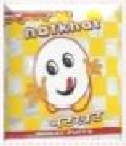
DFM Foods – digging deeper

Delhi Flour Mills pioneered packaged foods business in India with the launch of now well-known CRAX corn rings in 1984.

In the mid 80s the concept of packaged foods had still not found its feet in India; however the company ventured into the business on the suggestion by one of its Italian machine suppliers for its flour mill business.

In 1993, the DFM Foods came into being which till 2009 housed the wheat trading business and the snacks food business. In FY 10, the wheat trading business was discontinued to focus solely on fast growing snacks food business of the company.

The company's snacks food products are marketed under two brand names, 'CRAX' and 'NATKHAT'. Its product portfolio consists of:

	**Target Audience** - 6-10 year old children **Ingredients** - Corn based baked extruded snack **Gift** - Each pack contains a fun gift **Price Points** - Rs. 5, 16 grams and Rs. 10, 40 grams **Flavors** - Chatpata, TangyTomato, Masala Mania, Pudina Punch & Mast Cheez
	**Target Audience** - 6-10 year children in small towns & middle class areas in cities **Ingredients** - Baked & extruded wheat puff **Price Point** - Rs. 2, 12 grams and Rs. 5, 30 grams **Flavors** – Masala
	**Variants** – 11 variants of both popular and unique Namkeens **Price Points** - Rs. 2, 5, 10, 15, 30

CRAX Corn Rings – It's a corn based, non-fried snack available in different flavors. Thus, unlike fried potato chips, corn rings are relatively healthier. The company sells the product in two affordable packs of Rs 5/- and Rs 10/- respectively. Also, as the major target audience is children, the company includes small toys in the pack itself.

CRAX Corn rings account for 75-80% of the overall sales of the company and have a very strong brand recall especially in Northern and Central India.

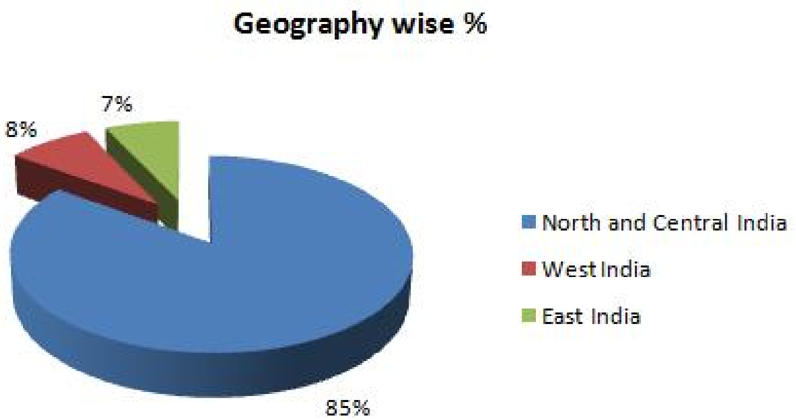
CRAX Namkeen – The promoters of DFM Foods have several decades of experience in procuring and processing food raw materials and Namkeens allow the management to leverage the brand CRAX in the traditional snacks segment. Here again the company offers several flavors, mixtures and pack sizes ranging from Rs 2/- to Rs 30/-. Namkeens contribute 10-11% to the overall sales of the company.

NATKHAT – Natkhat is again a relatively healthier snack as it is light-weight, crunchy wheat puff with low fat percentage. For several years the company had been retailing Natkhat at only Rs 2/- per pack but it recently introduced a relatively larger pack of Rs 5/- and the same has been garnering good response.

Like Namkeens, the contribution of NATKHAT has also increased to around 10-11% of the sales of the company.

Geographical distribution of sales – DFM Foods was pre-dominantly a north based player till a few years back and derived almost 100% of its sales from North and Central India.

In order to leverage the brand equity of its products, 4-5 years back the company started expanding its sales and distribution network in the western states of India and around 2 years back in the eastern states of India.



At the end of 9M FY 15, the company derived ~85% of its sales from North and Central India, 8% from Western India and 7% from Eastern India.

The company has now marked a small presence outside North India and the scope for expansion of distribution in all the 3 regions is immense as DFM's distribution reach is still much smaller in comparison to other large organized players.

The management is further looking to expand in South India and may soon appoint sales personnel for starting with two major cities of Bangalore and Chennai.

Volume and realization growth in snacks food over the years – Below we have produced an illustration on the volumes, sales and realization of snacks food business of the company.

Particulars	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	CAGR
Production (MT)	596	772	1367	1947	1898	2088	2396	2527	2576	2467	17.10%
Sales (in cr)	4.56	5.90	10.54	16.30	15.72	16.83	18.14	20.32	20.76	20.51	18.18%
Realization (per MT)	76510.07	76424.87	77103.15	83718.54	82824.03	80603.45	75709.52	80411.56	80590.06	83137.41	1.06%
Particulars	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	CAGR
Production (MT)	2467	2176	2413	2895	3605	4567	6565	9328	11853	13058	20.34%
Sales (in cr)	20.51	18.45	23.89	31.66	53.34	72.19	119.84	169.42	225.24	263.25	32.79%
Realization (per MT)	83137.41	84788.6	99005.39	109361	147961.2	158068.8	182543.8	181625.2	190027.8	201600.6	10.40%

In general in snacks food business a company can grow by either increasing volumes, or realizations or both and DFM Foods has a very good record of improvement in both volumes and realizations. From 1996 to 2005 the volume growth was good at 17.10% CAGR, however for various reasons the company could not improve its realizations much which grew at just 1% CAGR.

However the last 9-10 years have been extremely good for the company with the growth in volumes at 20% + CAGR, realizations at 10% + CAGR and the overall sales growing by 32.79% CAGR.

Similarly, over the last 5 years the company has delivered 29.35% CAGR in volumes and over 37.6% CAGR in sales.

While the past performance in terms of sales growth has been really good, we believe the long-term growth potential is immense as the sector itself is growing at a brisk pace, there is strong brand recall of CRAX and as pointed out above there's wide scope for expansion of sales and distribution network.

Manufacturing sites – The Company has two manufacturing facilities, 1 each at Ghaziabad and Greater Noida with total capacity of ~16,500 MT of snack food per annum.

The Greater Noida facility is a relatively new plant built at an outlay of ~75 crores with manufacturing capacity of ~10,000 MT per annum. As per the management, the infrastructure for further expansion has also been created, such that the next phase of capacity expansion can be executed in nominal time and with marginal costs.

Considering current capacity utilization of ~75% and provision for 30-40% expansion in manufacturing capacity at the existing locations, we believe over the next 2 years the company won't have to resort to very high CAPEX and the same should be manageable by internal accruals.

Savory Snacks industry

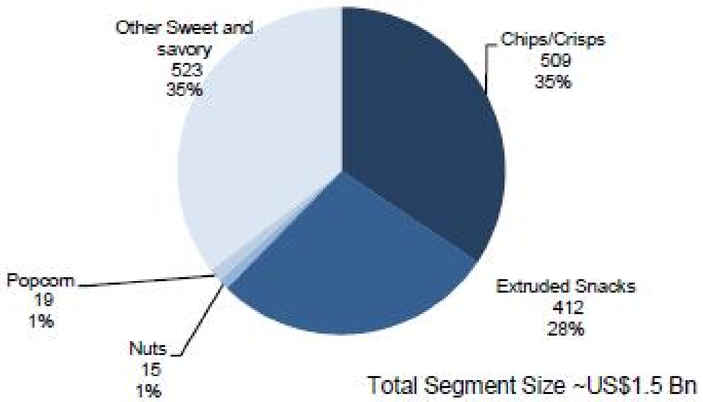
The word savory is rooted in the meaning of "tasty" or "flavorful", but lately it's used to describe "salty or spicy" flavours as opposed to sweet. Thus, savory snacks are snacks that aren't sweet.

Savory snacks are basically a sub-segment of impulse and indulgence products category and include Chips, Crisps, extruded snacks, nuts, popcorn and other traditional snacks such as Aloo Bhujia, Moong Dal, Papad and other Namkeens.

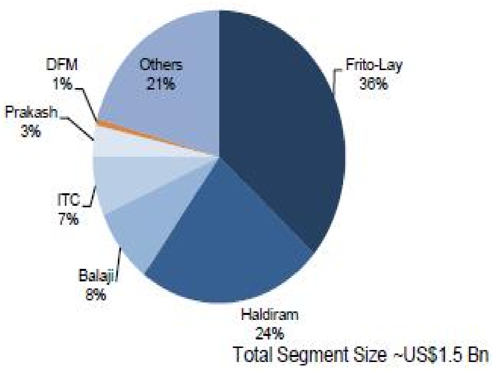
Industry size – Sweet and Savory snacks segment is further categorised into 'Western Snacks' and 'Traditional Snacks' which together gave it a market size of ~ Rs 10,000 crores in 2012 and further increased to ~ Rs 12,500 crores in 2013.

Indian sweet and savory snacks industry grew at a CAGR of ~26-27% during 2007-13 and is estimated to grow at a CAGR of 12.5% during 2012-2017 which is amongst the fastest in the Impulse and Indulgence products category. Frito-Lay is the category leader with ~36% market share at the end of 2012, however it has gradually been losing market share to smaller companies like DFM Foods, Prataap Snacks.

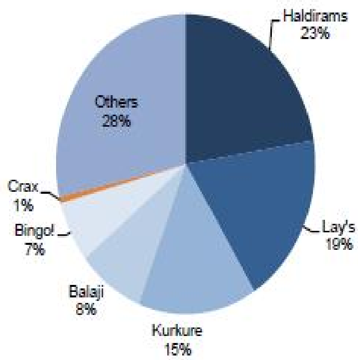
Segment Break – Up (2012, US$ Mn)[1]



Major Players Market Share (2012)



Major Brands Market Share (2012)



What's driving branded snacks food industry? Indians consumed more packaged salty snacks than any other fast moving consumer goods (FMCG) in 2013, as they emerged as the fastest growing grocery category, according to data compiled by researcher Nielsen.

Munching between two meals or at tea /coffee time is a habit with most Indians, however the growing branded snacks sector in India is a result of a demand for convenience and fuelled by rising disposable incomes.

Consumers now want variety and new tastes. Another factor that has worked towards the shift from the home-made snacks to the branded packs is the price. It is challenging to give quality and quantity at the price points of Rs 5 and Rs 10. The bulk of the consumers are in the middle and lower middle classes. Therefore, conversion from loose to packaged, new formats and convenient price points of Rs 5 and Rs 10 are key differentiators driving upwards the demand for branded snacks.

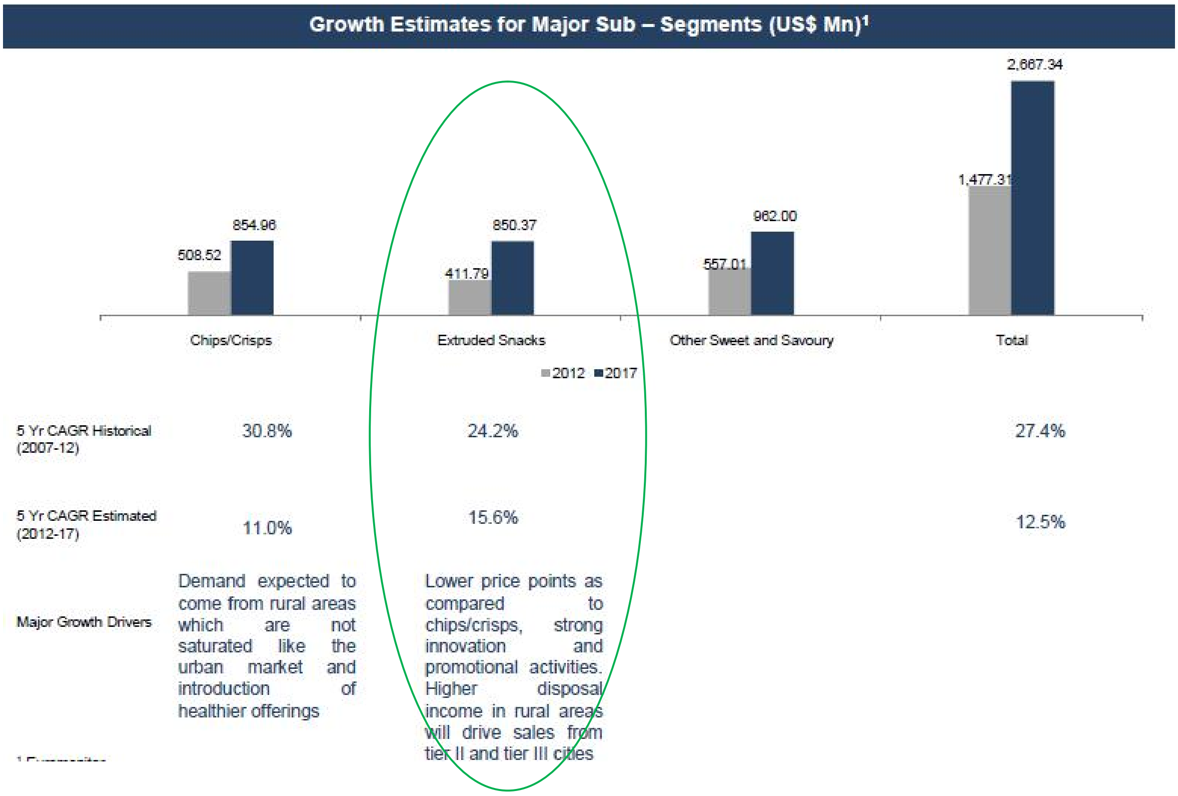
As per Euromonitor international, in 2013 only 28% of sweet and savory snack retail value in India came from rural areas and when combined with the fact that 68% of India's population live in rural areas, it's clear that sweet and savory snacks have only scratched the surface so far. Further, as per a 2013 report by consulting firm Technopak, the branded salty snacks market is projected to grow at a CAGR of 15-18 per cent over the next few years.

The growth outlook for the industry is indeed very bright due to expected increase in urbanization, busy schedules, changing eating habits and increasing influence of children in the purchase of packaged food items.

Extruded snacks – expected to grow at a faster clip in comparison to Potato Chips – Extruded snacks are snacks cooked, pressurized and pushed out of a die that gives them their unique shape. Extruded Snacks as a sub-category under sweet and savory snacks stands out amongst all other categories having registered very strong volume and value growth at above 20% during 2007-2013.

In extruded snacks market, Pepsico is the market leader with its home-grown 'Kurkure', while since the last few years smaller players like DFM Foods, Prataap Snacks have been making their presence felt through market share gains.

Extruded snacks are priced much lower than chips/crisps, are quite popular among children and much more affordable than other savory snacks.



As a result of their sales pitch of being healthier in comparison to chips and lower price points, extruded snacks are expected to report 16% CAGR over the next few years against 11% CAGR expected for Chips. Rural markets are still under-penetrated and lower price points (Rs 2, Rs 5 & Rs 10) prevalent in the segment could drive aggressive sales in rural India.

Some pointers towards expected higher growth of extruded snacks are that in US as well cracker segment is now the largest salty snack division, constituting almost one-fourths of the net sales in 2013. Back in 2011, potato chips was the largest segment of the U.S. savory snacks market with a 36% share, but its share has since fallen. This is mainly due to shifting consumer trends and healthier snacking habits, as customers look to switch to snacks using healthier ingredients such as high-protein foods, vegetables, and legumes.

It's important to note here and as indicated in the product portfolio segment of DFM Foods, unlike most of the chips/crisps, DFM's products are baked and not fried and constitute healthier ingredients such as corn and wheat.

DFM Foods – Performance Snapshot

Companies with consistent demonstration of earnings power, good return ratios, low or zero debt and simple businesses are in general good and safe investment opportunities unless bought at exorbitant valuations and as can be observed from the below performance illustration of DFM Foods, it ranks high in almost all the financial parameters mentioned above.

Particulars (in cr.)	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14
	Before discontinuation of wheat trading			Post discontinuation of wheat trading business				
Snacks food Production (in MT)	2413	2895	3605	4567	6565	9328	11853	13058
Income from operations (Snacks Food)	23.88	31.66	53.34	72.19	119.98	169.42	225.24	263.25
Total Cost of Goods sold				43.77	76.31	107.97	142.65	165.09
Gross profit				28.42	43.67	61.45	82.59	98.16
Gross Profit margin (%)				39.37%	36.40%	36.27%	36.67%	37.29%
EBITDA				7.36	14.89	20.00	21.02	22.64
EBITDA margin (%)				10.20%	12.41%	11.80%	9.33%	8.60%
Other Income								
Div/interest/exchange variation				1.28	1.4	2.77	2.82	3.88
Depreciation				-0.97	-1.41	-2.38	-4.38	-5.79
Interest				-1.32	-2.17	-4.47	-9.42	-8.49
PBT	0.17	1.99	6.17	6.35	12.71	15.92	10.04	12.24
Adjusted PAT	0.11	1.32	4.09	4.21	8.32	10.36	6.31	8.08
Net Reported PAT		0.78	2.00	4.21	8.32	10.36	6.31	7.10
ROAE	0.81%	10.14%	30.23%	27.73%	42.55%	39.21%	19.81%	22.67%
Cash flows from operations				14.85	12.08	13.01	12.98	11.57
Net debt	2.01	25.05	6.77	5.38	8.01	57.29	63.36	33.84

As mentioned in the introductory section, prior to FY 10, DFM Foods was also into wheat trading business and discontinued the same at the end of FY 09. In the above illustration, for FY 07 to FY 09 we have covered the performance of snacks food business based on the segmental details shared by the company in its Annual Reports.

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Over the years the company has consistently reported very strong growth in volumes and backed up with gradual increase in sales realization per tonne. What is important to note is that despite higher base the last 9-10 years have witnessed much higher growth in both volumes and realizations in comparison to late 90s and early 2000 indicating both stronger focus of the management on the snacks food business and probably growing acceptance of branded savory snacks with Indians.

We believe maintenance of gross margins (unless major change in product mix) is an important indicator of pricing power and as can be observed in the performance snapshot of the company, it has consistently been able to maintain gross margins in the range of 36-39% with minor changes on year on year basis.

Particulars (in cr.)	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14
Toys (Part of raw material)					34.15	28.56
Adv, publicity and sales promotion	3.30	4.25	5.38	6.69	10.46	12.59

Further, it is very important to know that as a brand building measure among its target audience of children, company includes very small toys in its packs and accounts for those toys as a part of raw material. We believe toys should be accounted as a part of sales promotion and therefore believe that gross margins of the company are much higher at ~50%.

On the same lines, on including toys as a part of advertisement, publicity and sales promotion, the company spends almost ~17-18% of its sales on brand building and promotion.

EBITDA margins and overall profitability – Since the last 2 years the EBITDA margins of the company have declined from the highs of 12%-12.5% to around current levels of 8.60%.

Towards the end of FY 11 the company started working on a major CAPEX of 75 crores to expand its capacity by more than 160% and the same came on stream in FY 12. Also, the new facility was built at a new location.

With the commissioning of new plant, the company started incurring fixed operating costs while the capacity utilization improved only gradually. Also, as the company started sales and distribution in western and eastern India, the same also impacted the margins of the company to a certain extent.

Further, as the CAPEX was funded with debt of ~50 crores, both interest and depreciation cost impacted the before tax profitability of the company.

What has changed now that can improve the profitability? We believe, for the next few years there are several factors that can lead to overall improvement in the profitability of the company and they are as below:

- Earlier the capacity utilization was low, however the company has now reached capacity utilization of ~75% and from here on there should be further improvement resulting in operating leverage
- The company has established its sales and distribution in eastern and western India and incremental cost of expansion in the two regions should be lower
- The capacity can be further expanded by 30-40% at existing locations and therefore CAPEX cost per tonne of additional capacity will be substantially lower than greenfield expansion carried out by the company in the past and since the expansion will be at existing locations, the addition in overheads should also be lower
- The company had taken substantial debt for the CAPEX, however the net debt of the company is now down to around ~10 crores (from the highs of 50-60 crores) which should result in savings in interest cost

- The depreciation charge will remain almost same while the company will accrue benefits of higher capacity utilization

Besides, the company is also working on rationalization of operating cost including changes to packaging and its impact was evident in 9M FY 15 results of the company which saw EBITDA margins at 9.92% against 9.07% in 9M FY 14. The improvement in margins has been achieved despite muted growth in sales.

For FY 16, assuming very modest growth of 15-18% (over the last 3, 5 and 10 years cycles the company has consistently recorded 20% growth) and EBITDA margins of 9.6-10%, we expect the company to record pre-tax earnings of 22-23.50 crores.

Over the longer run i.e. 5-10 years, we believe that the outlook is very positive on account of strong positioning of brand CRAX and overall growing demand for branded snacks food category in India. Further, in future if the company is able to outsource manufacturing, there could be substantial gains in terms of much higher flexibility and profitability.

Shareholding pattern

	Mar'15	Dec'14	Sep'14	Jun'14	Mar'14
Promoter and Promoter Group	**44.18%**	**44.18%**	**44.18%**	**44.18%**	**44.18%**
India					
Foreign	44.18%	44.18%	44.18%	44.18%	44.18%
Public	**55.82%**	**55.82%**	**55.82%**	**55.82%**	**55.82%**
Institutions	9.96%	9.96%	9.96%	9.96%	9.96%
FII	9.95%	9.95%	9.95%	9.95%	9.95%
DII	0.01%	0.01%	0.01%	0.01%	0.01%
Non-Institutions	45.86%	45.86%	45.86%	45.86%	45.86%
Bodies Corporate	1.26%	1.27%	1.18%	1.36%	1.29%
Custodians	--	--	--	--	--
Total	**10,001,676**	**10,001,676**	**10,001,676**	**10,001,676**	**10,001,676**

From a passive investor's perspective it's important for the ones running the company to have high ownership as it aligns their interest in line with those of minority shareholders and in the case of DFM Foods the promoters own reasonable stake at 44.18%.

In fact, till Dec'13 the promoters had 69% stake in the company, however in Jan'14 the promoters entered into a share sale agreement with Westbridge Crossover Fund and Jwalamukhi Investment holdings (investment arm of Westbridge) and sold their 24.90% stake in the company @ 259.10 per share.

With the above transaction, one of the MDs of Westbridge Capital, Mr. Sandeep Singhal was appointed as an Additional Director on the board of DFM Foods. Mr. Singhal brings with him rich experience on board and with Westbridge's 24.90% stake, he will be more than interested in the success of DFM Foods.

As far as Westrbridge Crossover fund, it was launched following the sudden departure of the founding partners of Sequoia Capital India-- Chadha, KP Balaraj along with Sandeep Singhal and SK Jain to resurrect WestBridge Capital Partners. Westbridge primarily invests in small and mid cap publicly listed companies with longer term investment outlook and has a very good track record of stock selection.

As on 31st Mar'15, the major shareholders of the company and their stakes are as below:

Name of the shareholder	Category	% stake in DFM Foods
Promoters and PAC	Promoters	44.18%
WestBridge Crossover Fund LLC	Public	14.95%
Man Mohan Singh	Public	10.03%
HSBC Bank A/c Jwalamukhi Investment Holdings	Public	9.95%
Anuradha Sharma	Public	2.91%

Dividend Policy

Dividend Payout ratio					
	FY 10	FY 11	FY 12	FY 13	FY 14
Dividend Payout ratio	35.62%	24.04%	24.13%	39.62%	35.21%

DFM Foods has a generous dividend policy with average payout of ~30%. The company's only major capital requirement is for expansion of manufacturing capacity. That too occurs after a gap of few years and mostly manageable by internal accruals in case of brownfield expansion.

The company's cash flow generation is very strong with zero receivables on account of cash sale and low level of inventory taken care of by payables and advances from customers.

Valuations

(₹ in Lacs)

Particulars	As at 30/09/2014 (Unaudited)	As at 31/03/2014 (Audited)
A. EQUITY AND LIABILITIES		
1. Shareholders' Funds		
(a) Share Capital	1000	1000
(b) Reserves and surplus	3288	2773
Sub-Total - Shareholders' Funds	4288	3773
2. Non - Current Liabilities		
(a) Long - term borrowings	2646	3245
(b) Deferred tax liabilities (net)	685	648
(c) Other long - term liabilities	783	702
(d) Long - term provisions	78	41
Sub-Total - Non-Current Liabilities	4192	4636
3. Current Liabilities		
(a) Short - term borrowings	372	491
(b) Trade payables	1952	1135
(c) Other current liabilities	2269	2214
(d) Short - term provisions	164	410
Sub-Total - Current Liabilities	4757	4250
TOTAL- EQUITY AND LIABILITIES	13237	12659
B. ASSETS		
1. Non - Current Assets		
(a) Fixed assets	8936	9112
(b) Non - current investments	2	2
(c) Deferred tax assets (net)	-	-
(d) Long - term loans and advances	175	139
(e) Other non - current assets	15	91
Sub-Total - Non-Current Assets	9128	9344
2. Current Assets		
(a) Current Investments	1945	1400
(b) Inventories	1657	1491
(c) Trade receivables	-	1
(d) Cash and cash equivalents	232	226
(e) Short - term loans and advances	65	174
(f) Other current assets	210	23
Sub-Total - Current Assets	4109	3315
TOTAL - ASSETS	13237	12659

We have attached the balance sheet of DFM Foods as on Sep'15. There are certain important points about the same and they are as below:

The company's net debt is only about 10 crores with 30 crores as gross debt and 20 crores in the form of cash and equivalents.

The long term liabilities of 7.8 crores are basically the security deposits from distributors and stockists.

The company's receivables are zero on account of cash sales while the inventories are more than taken care of by trade payables and advances from customers.

Considering very strong cash flows from operations, the company is likely to achieve debt free status in next 2-3 quarters.

Let's also recall all that we have learnt about DFM Foods in the above sections:

- DFM Foods is one of the pioneers of branded snacks food in India as it launched modern snacks in the form of CRAX and NATKHAT way back in 1980s.
- CRAX corn rings command leadership position in the roasted corn snacks segment and caters largely to the ready to eat snacks demand of children in the age group of 6-14 years.
- The company's products are relatively healthier snack foods as based on corn and wheat and unlike other fried products available in the market, they are baked.
- DFM is planning to leverage the CRAX brand by launching it across a wider product range and age group outside the current target group.
- While DFM derives 75% of its sales from North and Central India, its products have a strong brand recall across India. Since the last 3-4 years the company has been expanding outside North India and now derives 8% of its sales from west India and 7% from east India.
- The scope for expansion of distribution in all the 3 regions is immense as DFM's distribution reach is still much smaller in comparison to other large organized players.
- The company's capacity utilization is ~75% at present and there's scope for 30-40% expansion in manufacturing capacity at existing locations and therefore we don't see any major CAPEX requirement for the next 24-30 months.
- Savory snacks are one of the fastest growing consumer goods in India. Munching between two meals or at tea /coffee time is a habit with most Indians, however they are now graduating from loose to packaged, branded products on account of both convenience rising disposable incomes.
- Strong and consistent operating performance of DFM Foods in terms of industry-beating growth, margins, return on equity, cash flow generation. From the current levels, there are several levers for expansion of margins and profitability at DFM Foods.
- Very low debt of 10 crores and considering very strong cash flows, likely to emerge debt free in next 2-3 quarters.
- Experienced promoters and long term investors with their interests directly aligned with those of minority shareholders.

Coming back to valuations, for FY 16, assuming very modest growth of 15-18% (over the last 3, 5 and 10 years cycles the company has consistently recorded 20% growth) and EBITDA margins of 9.6-10%, we expect the company to record pre-tax earnings of 22-23.50 crores.

The valuations of the company might seem slightly high, however considering the past performance, the quality of the business, the brand equity and the scale of the opportunity, we expect the company to continue to trade at premium valuations of 14 times 1 year forward pre-tax earnings (E).

Risks & Concerns

- Last 3 quarters have witnessed moderation in growth and if the same persists, there's downside risk to our FY 16 pre-tax earnings estimate of 22-23.50 crores.

- In the past the company has granted loans to the promoter group entities and the same has resulted in some strain at DFM's own balance sheet. Though promoter's have paid off the entire amount, it will be important for shareholders to watch out for similar such transactions and their impact on DFM Foods in the future.

- The company sells its products at price points of Rs 5/10 and thus faces limitations in terms of raising the prices due to coinage issues and has to reduce volume offered per pack to raise the prices indirectly.

- Due to the small size of the company and complete lack of experience in outsourcing model, for now the company is entirely dependent on its own manufacturing. We believe, in the longer run the 100% own manufacturing model will limit the growth of the company and expansion into far away geographies due to smaller shelf life of the products and the management will therefore have to consider outsourcing model as well to sustain the growth rate.

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