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DEMOCRATIZING WEALTH CREATION

VALUE PICK
CHASING VALUE, NOT PRICES

Company Name	:	**DFM FOODS**
BSE Code	:	**519588**
Time Duration	:	**1 year**
CMP	:	**₹1392 (as on 13 July, 2017)**
Target Price	:	**₹1835**

The Value pick for the month of July is DFM Foods, a leading manufacturer of packaged snack foods. It flagship brand Crax contributes ~81% to the revenue. The company is also investing in building new brands – Namkeens and Natkhat which contribute 10% and 9%, respectively. It is also looking at expanding its geographical footprint in western and southern markets. We see that the company's share price has corrected sharply due to margin pressure as the company is facing weaker demand due to high competition and impact of demonetisation. Additionally, the higher marketing expenses fell short of achieving the expected sales target.

We see that the company has been diversifying and entering new product categories. Also, it has sound and candid management which gives us confidence of a revival in margins. The company faced exceptionally slower demand in FY17 which we believe will revive with new product launches and foray into new geographies.

Launch of new products

Crax brand is the major contributor towards the total revenue of the company, with ~81% of the business coming from Crax corn rings. Other snack items like Crax Namkeens and Natkhat (another brand) contribute the remaining to the total revenue. The company recently launched Crax curls snack item at pan-India level. It is also planning to launch another product named Crax cheese balls which is under the process of testing. The management expects to launch the product soon in the market. The margins for Crax curls product is lower than Crax rings. Such low margin is justifiable as this new product is launched with larger pack size at a competitive attractive price. Once it gets penetrated in the market, we expect the product to deliver higher margins.

Brownfield expansion to augment capacity by 37%

The company's 80% of the business comes from the North Indian zone, including New Delhi and Noida. The second brownfield expansion was commissioned in March 2017 by investing Rs.62cr for the plant. This will expand the capacity by 10,000 MTPA, thereby increasing the capacity to 26,500 MTPA. The management expects to generate additional revenue of Rs.175cr to 200cr in the next couple of years from this expansion. Another manufacturing facility is in the pipeline to be set up in Pune. This will help serve western, central and southern markets. It has also forayed into towns like Vijayawada and Vishakhapatnam in Andhra Pradesh. Few towns outside the three metros in South India were also targeted this year.

GST and new tax regime

The Namkeens industry is growing at a rate of 8-10%. With large portions of it operating as unorganized segment, we expect GST to provide level playing field. However, the GST rate of 12% vs 12-5% (as per states) earlier will lead to price rise. We believe due to stiff competition, the industry's ability to pass on the price hike will be difficult. The government is in consultation with the industry and snack food association to look into the rates. However, the management expects it to have a neutral impact as the company was paying excise on inputs which was not refunded. Now these will be refunded and will neutralize the impact of GST.

We believe Q1FY18 and Q2FY18, will again be a softer quarters and volumes are expected to pick up by Q3FY17. As clarity emerges from the implementation of the GST, the company will be more focused and will gain market share in new geographies.

Financial Performance

The company's revenue has shown continuous upward trend from FY11. However marginal de-growth in revenue was seen in FY17 due to demonetisation. Its financial performance in Q3 and Q4 of FY17 was weak, compared with the corresponding quarters of FY16. Its revenue in FY17 was reported at Rs 344.89 cr, i.e. de-growth of 11.3% YoY, due to lower sales of rings. The operating profit margin declined from 12.09% to 9.92% in FY17 due to high employee cost and advertising costs pertaining to the new product launch. Net profit margins too declined from 6.42% to 4.6% in FY17. We expect the revenue will show revival as the demonetisation impact has faded away and increased consumption will drive demand .

The company's debt-to-equity ratio in FY17 stood at 1.07x versus 0.65 in FY16. This was due to raising of a fresh term loan of Rs 56cr to fund its brownfield expansion plans in Greater Noida. The company has paid dividend of 50% i.e. Rs 5 per share for FY17.

Valuation and Outlook

The company is trading at TTM P/E of 87.2x with TTM EPS of Rs.15.87. We expect EPS to improve as the revenue and profitability increases going forward. The company has delivered ROE of 45.3% in FY17. The stock has corrected from high of Rs.2,200 due to weakness in earnings. We believe with expected growth in earnings, the company can reach target price of Rs.1,835 over a year.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201703	201603	201503	201403	201303
Net Sales	344.89	388.95	288.73	262.90	224.95
Total Income	344.89	389.51	289.25	263.25	225.24
Total Expenditure	317.94	348.91	264.19	246.40	208.41
PBIDT	26.95	40.60	25.06	16.85	16.83
PAT	15.87	25.04	11.01	7.10	6.31
Dividend %	50.00	50.00	25.00	25.00	25.00
Adj. EPS(Rs)	15.87	25.04	11.01	7.10	6.31

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201703	201612	Q on Q Var%	201603	Y on Y Var%
Net Sales	93.17	87.15	0.07	122.78	-0.24
Total Expenditure	86.74	78.94	0.10	106.04	-0.18
PBIDT (Excl OI)	6.43	8.35	-0.23	16.93	-0.62
PAT	3.66	5.04	-0.27	11.62	-0.69
PBIDTM% (Excl OI)	6.90	9.56	-0.28	13.76	-0.50
PBIDTM%	5.35	7.60	-0.30	13.00	-0.59
PATM%	3.92	5.77	-0.32	9.44	-0.58
Adj. EPS(Rs)	3.66	5.04	-0.27	11.62	-0.69