

ADF Foods

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Reuters: AMRN.BO; Bloomberg: ADFL IN

All Spiced Up!

We had a meeting with the management of ADF Foods recently. Started in 1932 as a small retail store selling dry fruits and nuts under the name of Americh Dry Fruit Stores from where it gets its current name, ADF Foods diversified into a major food processing company. ADF Foods' legacy business is primarily food exports, targeting different parts of the world including the US, UK and Middle East. ADF Foods today operates in 55 countries, making it one of the leading ethnic Indian food companies in the world. ADF Foods acquired Elena's Foods in November 2010, an US company manufacturing and distributing organic Mexican foods across the mainstream market in the US. This business faced tough times over the past six years, but recently ADF Foods transitioned from self manufacturing to third party contract manufacturing which will help it to make considerable savings, improve gross margin and reduce the break-even period. ADF Foods will also be concentrating on packaged foods and frozen foods market in India in the next five years. After hiving off its successful brand called Mother's Recipe in 2005 to Desai Brothers, in 2011, ADF Foods launched its new domestic packaged and frozen food range under its umbrella brand, Soul. ADF Foods has two manufacturing plants in India, one in Nashik, Maharashtra, and the other in Nadiad, Gujarat. These plants cater to export as well as domestic markets. ADF Foods has successful brands like Ashoka, Camel, Truly Indian, PJ's, Nate's, Aeroplane and Soul across the globe in its portfolio. ADF Foods currently is present in six Indian metro cities/states, namely Maharashtra, Gujarat, Madhya Pradesh, Delhi NCR, Bangalore and Hyderabad. ADF Foods plans to reach a total of 50 cities across India, widening its distribution reach by the end of FY17. The company's domestic flagship brand, Soul, is currently available in 10,000 traditional outlets along with modern retail outlets like Big Bazaar, Reliance, D-Mart, Total, Star Bazaar, Nature's Basket, Spencer's, Metro and Vishal and also has online presence on Big Basket and Just Buy Live.

NOT RATED

Sector: Packaged Foods

CMP: Rs121

Aditya Joshi

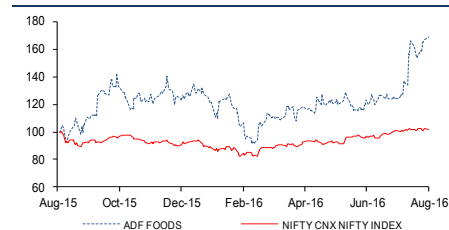
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Key Data

Current Shares O/S (mn)	22.0
Mkt Cap (Rsbn/US\$mn)	2.7/40
52 Wk H / L (Rs)	124/63
Daily Vol. (3M NSE Avg.)	252,449

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
ADF Foods	35.7	71.3	68.3
Nifty Index	1.2	20.6	1.4

Source: Bloomberg

Y/E March (Rsmn)- Consolidated	FY12	FY13	FY14	FY15	FY16
Revenue	1,565	1,800	2,089	2,046	2,091
YoY (%)	21.3	15.0	16.0	(2.1)	2.2
EBITDA	197	166	159	156	198
EBITDA (%)	12.6	9.2	7.6	7.6	9.5
PAT	61	138	48	88	66
YoY (%)	(56.6)	125.2	(65.4)	85.1	(25.2)
Net Profit Margin (%)	3.9	7.7	2.3	4.3	3.2
FDEPS (Rs)	3.2	6.4	2.6	4.0	3.0
RoE (%)	5.5	10.5	3.2	5.9	4.4
RoCE (%)	8.1	11.5	4.7	7.5	5.6
P/E (x)	37.4	18.5	46.0	29.4	39.3
Book Value per share (Rs.)	55.8	67.6	67.1	69.4	69.5
P/BV (x)	2.1	1.7	1.8	1.7	1.7

Source: Company, Nirmal Bang Institutional Equities Research

Key takeaways from our interaction with Mr. Bimal Thakkar, managing director of ADF Foods

The focus was on following areas:

1. Export business(legacy business)
2. US business
3. India business
4. Manufacturing plants
5. Brands across the globe
6. Product portfolio
7. Raw material cost inflation
8. Forex movement and exposure
9. Distribution and expansion plan
10. Vision 2020
11. History of 'Mother's Recipe'

1. Export business

- ADF Foods' legacy business is export business whereby the company exports ready-to-eat food, canned foods, chutneys, pastes, pickles and frozen foods.
- The company operates in 55 countries currently with a network comprising more than 180 distributors.
- ADF Foods plans to expand in these countries further by reaching more number of outlets and super markets.
- This business will be in expansion mode and an investment of Rs.70mn-Rs80mn will be made which is expected to result in revenues of Rs1bn-Rs1.1bn going forward in next 5 years..
- Owned and private label manufacturing ratio is 70:30.
- ADF Foods exported 10mn *samosas* (an Indian snack) last year.

2. US business

Acquisition

- ADF Foods acquired Elena's Foods in November 2010, which was manufacturing and distributing organic Mexican foods across the mainstream market in the US.
- Elena's Foods was acquired for less than US\$5mn for 89% stake in the company having sales revenues of below US\$9mn in 2010. The remaining stake of 11% is held by previous owners of the company with callable option (it was later acquired by ADF Foods).

Post-acquisition

Year 1- After the acquisition of Elena's Foods in 2010, ADF Foods witnessed a dip in sales in 2011.

Year 2- In 2012, this business achieved break-even.

Year 3- Turned EBITDA positive.

Year 4- In 2014, one of the previous partners materially modified the product recipe without appropriate management approval which led to product recall by most stores, delivering a big blow to the US business of ADF Foods.

Year 5- ADF Foods exercised its call option on the stake held by previous owners and acquired their 11% stake in Elena's Foods.

Year 6

- ADF Foods shut down its plant which was based in San Francisco and shifted to a contract manufacturing facility set up in Cleveland.
- Shutdown costs were US\$3.25mn.

- ADF Foods' US business faced a setback when some manufacturing machinery for burritos (hand-made earlier) was not delivered on time in January-March, 2016 because of bankruptcy filing by the manufacturing company. A new company took over the bankrupt company and the machinery is likely to be delivered in October, 2016. This event led the US business to take a hit following loss of revenues.

Synergies

- Post shifting to contract manufacturing, the US business is now an asset-light model with cost savings
- Gross margin improvement of 10%-12% is likely because of the asset-light model.
- Advertisement and promotion or A&P spending to sales ratio currently is 25%-30%, which will be normalised in the range of 20%-25%.
- US business has more than 500 stock-keeping units or SKUs.
- Replacement costs for this facility was US\$5mn.
- ADF Foods' US business has Nate's- a vegetarian brand - and PJ's - a non-vegetarian brand. US operations also sells Truly Indian brand mainly catering to non-resident Indian community in the US.
- ADF Foods' US business focus is more now on organic food, which is a new food market trend witnessed in Western countries.
- The number of employees has come down from 70 at the earlier factory in San Francisco to 7 in Cleveland currently where rolling burritos is fully automated which will result in labour cost savings.
- US business registered total sales of US\$8mn in FY16, out of which private label business accounted for US\$1.5mn.

3. India business

- In 2011, India business had its flagship brand, Soul, which is currently in expansion stage.
- Pickles, pastes, dry spices and sauces are sold under Soul brand, which will expand further going forward.
- Soul brand achieved sales of Rs150mn in FY16.
- ADF Foods will further increase its Indian business by expanding distribution reach to 1,00,000 outlets by the end of FY17 from present 10,000 traditional outlets.

4. Manufacturing plants

	Nashik, Maharashtra	Nadiad, Gujarat
<i>Products manufactured</i>	<i>Pickles, pastes, chutneys, ready-to-eat curries and spices</i>	<i>Pickles pastes, chutneys, ready-to-eat curries, spices, canned food and frozen foods.</i>
<i>Built-up area</i>	<i>10,100 sq metres (1,50,000 square feet)</i>	<i>15,000 square metres (2,00,000 square feet)</i>
<i>Unique manufacturing unit</i>	<i>Spice processing</i>	<i>Frozen foods- parathas, snacks, vegetables, canned ready-to-eat items, canned vegetables.</i>
<i>Technology</i>	<i>Imported from Buhler, Germany</i>	-
<i>Certification</i>	<i>ISO,9001, ISO 22000 and BRC</i>	<i>ISO 9001, ISO 22000 and BRC</i>
<i>Expansion</i>	<i>Yes –New plant with Rs100mn capex. Organic food products will be produced here.</i>	<i>No</i>

5. Brands across the globe

Camel

- Camel is a premium brand of pickles in Middle East market which offers a range of pickles and spices.
- Camel is a 100-year-old brand which was acquired in late 70's.
- It has presence in Saudi Arabia, Iraq and other Middle East countries.
- 10%-12% of the revenues come from this brand.
- This brand added Rs.150mn to the top-line in FY16.

Aeroplane

- Aeroplane is an economy brand in Middle East.
- Pickles and sauces are sold under this brand.
- Aeroplane registered sales of Rs160mn in FY16.

Truly Indian

- Truly Indian is a four-year old brand targeting NRIs initially, but now mainstream non-Indians are targeted as well
- Sauces, ready-to-eat curries, pastes and poppadum (papad) are sold under this brand.
- Chilly content has been reduced to cater to the requirement of non-Indians as well.
- Organic foods and sauces will be launched under this brand in October 2016.
- Currently, Truly Indian is available in the US and Germany.

Ashoka

- Ashoka is flagship brand is primarily targeted for Indian diaspora worldwide with over 300 products in different categories under shelf stable and frozen range.
- Pickles, pastes, chutneys, sauces, frozen vegetables, snacks, frozen breads and ready-to-eat curries are sold under this brand.
- Dosa wraps is a new product which will be launched under this brand after Diwali festival.
- Camel, Aeroplane, Truly Indian and Ashoka brands will witness investment in brand development in the range of Rs.70mn-Rs80mn in FY17.

Soul (India)

- Soul is a five-year-old urban-centric brand which was launched in India in 2011 and has recently done innovation with pickles being prepared in olive oil and with lesser salt content.
- Soul brand's olive oil pickles are sold at a 10% premium compared to regular pickles.
- Gross margin in Soul brand stood at 32% in FY16 and expected to touch 37%-40% by FY17.
- This brand will be in investment mode with brand development expenditure of Rs30mn in FY17.
- Rs150mn will be spent till 2020 and the brand expected to achieve break-even by then.
- Soul currently registers revenues of Rs100mn which are expected to multiply 10x in five years.

Nate's (US)

- Nate's is ADF Foods' US brand which mainly offers vegetarian options.
- Nate's USP is its non-GMO and vegetarian food which is witnessing a lot of action in the US.
- Nate's sales stood at US\$2.5mn-US\$3.0mn in FY16.
- Nate's will be launching Mediterranean Bites with falafel twists in FY17. Also, Katti rolls/roti rolls, chaat items and Bombay chaat will be launched under this brand.

PJ's (US)

- It is a non-vegetarian brand under ADF Foods' US business.
- PJ's sells burritos under this brand.
- PJ's registered sales of US\$3.0mn-US\$3.5mn in FY16.

6. Product portfolio

- ADF Foods has pastes, pickles, dry spices, frozen food and ready-to-eat items.
- *Pickles*- It is Rs5bn organised market in India.
- *Ginger-garlic paste*- Rs3bn-Rs4bn market in India.
- *Instant masalas (spices)* - Rs2bn market in India.
- *Raw dry masala (spices)*- Rs50bn market in India.

- Sauces – Rs1.0bn-Rs1.5bn market.
- Each category's growth is in the range of 20%-22%.

7. Raw material cost inflation and gross margin

- Oil-** ADF Foods uses sunflower oil, rice bran oil and olive oil in its products. Olive oil is imported whereas other oils are sourced locally. There is no price contract for this commodity.
- Spices-** They are sourced locally and their prices fluctuate every year.
- Mangoes /vegetables-** Raw mangoes comprise 30%-35% of total raw materials required by ADF Foods. Green vegetables are stocked in the winter season. Mango prices shot up last year and hence ADF Foods' export business took a hit.
- Sugar -** It is also an essential part of pickles and witnessed a spike in price in the past one year. High sugar and mango prices led to a decrease of 400bps in gross margin of export business.
- Gross margin -** Domestic business enjoys 32%-33% gross margin whereas international (export) business has 45% gross margin. Frozen foods, as a category, enjoys highest gross margin of 55%.

ADF Foods, with its new product launches being gross margin-accretive, will help achieve 40% growth in domestic business.

8. Forex movement and exposure

- ADF Foods has exposure to most of the currencies because of its presence across the globe.
- Around Rs500mn revenues were in British Pounds which was impacted by Brexit
- ADF Foods hedges 50% of its total foreign exchange exposure.

9. Distribution and expansion plans

- Distribution in modern trade only as all brands are urban-centric.
- Currently, ADF Foods is present in 55 countries with over 180 distributors worldwide. It plans to plan to penetrate further in current markets.
- ADF Foods' products have reached 10,000 retail outlets, and the company plans to reach 1,00,000 outlets by the end of FY17.
- Currently, the company's products are available at top six cities in India and it plans to expand to 50 cities, most of them metros, across India.
- Modern trade channels will be the target with online smart trade channels.

10. Vision 2020

- ADF Foods' target for 2020 is to achieve Rs5,000mn of revenues.
- The company plans to increase domestic sales from Rs100mn-Rs125mn to Rs1,000mn-Rs1,250mn (10x in five years) by expanding its distribution reach.
- ADF Foods' US plan is to double its revenues to US\$16mn-US\$17mn by 2020.
- ADF Foods' international business is expected to contribute Rs2,750mn by 2020.
- Modern trade and smart trade expected to contribute 30%-40% to total revenues.
- Plans to reach more than 1,00,000 distribution outlets with a presence in more than 50 cities.

11. History of *Mother's Recipe*

- *Mother's Recipe* brand was launched in 1992 and it achieved sales of Rs.80mn-Rs100mn by 2005.
- The brand was developed over a period of seven years from 1992-2005 and later sold to Desai Brothers for a consideration of less than 1x its sales.
- Today, *Mother's Recipe's* total sales are in the range of Rs900mn-Rs950mn.

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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