

February 23, 2021

## Bengaluru Co-operative Milk Union Ltd: Rating reaffirmed; rated amount enhanced

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Working capital facilities	75.00	200.00	[ICRA]BBB+ (Stable); reaffirmed
Fund based – Term loan	10.00	-	-
Non-fund based – Interchangeable	(25.00)	(25.00)	[ICRA]BBB+ (Stable)/A2; reaffirmed
Unallocated limits	15.00	-	-
<b>Total</b>	<b>100.00</b>	<b>200.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating reaffirmation continues to factor in Bengaluru Co-operative Milk Union Ltd's (BAMUL/the union) dominant position in the Karnataka dairy industry being the largest union and receiving support from Karnataka Co-operative Milk Producer's Federation Limited (KMF/the federation). The rating takes comfort from the union's established procurement network of dairy farmers supplemented by presence of bulk coolers and chilling centres, which ensures regular supply of milk. The rating also factors in its long track record and strong brand name of Nandini, which has presence across a range of milk and milk products. The rating is supported by the continuous growth in its operating income (OI), despite moderation in the current fiscal caused by weak sale in H1 FY2021 owing to weak demand and logistical constraints aggravated by the Covid-19 pandemic. However, the sales have revived with demand revival across its product segments. Moreover, while the union was incurring heavy capex earlier and was awaiting loan disbursements, subsequently the said capex has been commissioned and the liquidity position of the union has improved.

The rating, however, is constrained by the modest profitability of BAMUL's business, given the nature of dairy cooperative model, which includes passing on benefits to farmers and increased milk procurement during weak demand to protect the farmers from excess milk. Moreover, the union's profitability was impacted in the current financial year owing to fall in skimmed milk powder (SMP) prices and build up in its stock over H1 FY2021. Consequently, its profitability and debt coverage metrics are expected to be weaker in FY2021. Nevertheless, rising prices over the recent months and the union's flexibility to adjust earmarked funds to fund the devaluation-related losses provide some comfort. Thus, in addition to movement in SMP prices, BAMUL's profitability remains vulnerable to external factors, such as bad weather, disease outbreaks and government-imposed regulations such as procurement price revisions. The rating continues to remain constrained by the commoditised nature of operations, stiff competition from organised co-operatives, private players and unorganised players, as it follows fixed pricing model unlike the private dairies.

The Stable outlook reflects ICRA's belief that BAMUL will continue to benefit from its long track record of operations, strong brand, diverse product portfolio and robust distribution network. Moreover, the Indian dairy industry is expected to continue to grow on the back of steady supply of milk, with India being the world's largest milk producer. Increase in demand for milk and milk products due to rising disposable income and increasing health consciousness support the demand outlook.

## Key rating drivers and their description

### Credit strengths

**Established market position led by dominant standing in cooperative value chain of KMF with robust procurement setup –** BAMUL is the largest union among the 14 milk unions under KMF. With the commencement of new Kanakapura dairy operations from January 2019, the union has an aggregate milk processing capacity of 18.0 lakh litres per day (LLPD) and it procures more than 15.5 LLPD of milk across Bengaluru urban, Bengaluru rural and Ramnagara districts of Karnataka under the dairy cooperative model. At present, BAMUL is associated with ~2,400 dairy cooperative societies covering ~3,500 villages and the procurement is facilitated by bulk milk coolers and chilling centres to maintain the cold chain. With the addition of new DCS year on year, the average milk procurement per day increased to 17.08 LLPD in 6M FY2021 from 12.70 LLPD in FY2015.

BAMUL sells liquid milk through a network of ~1,960 retailers, 81 franchised outlets and 47 own milk parlours through 363 distribution routes. As per the cooperative union model, outside the local market, all milk products processed by BAMUL are purchased by KMF and are marketed under the Nandini brand. BAMUL sells the excess milk to KMF, which are sold to deficit unions and in bulk to retailers across south India.

**Support from KMF and state government in form of grants, funds and schemes –** All the unions under KMF receive support in the form of grants to support capex requirement of the unions. This apart, BAMUL earmarks various funds linked to milk sales volumes and purchases to utilise for various requirements. In FY2021, in absence of any large capex plans, the union used these funds to fund its operating losses. The aforesaid flexibility apart, the Government of Karnataka (GoK) currently provides to the farmers a milk purchase subsidy of Rs. 5.0-6.0/litre of milk procured through DCS. Apart from grants and incentives (directly to farmers), BAMUL's revenue base benefits from government-backed schemes for selling milk and milk products.

**Healthy revenue growth despite moderation in current fiscal –** BAMUL's revenue (before adjusting infrastructure fund) grew by 19.14% to Rs. 2,489.2 crore in FY2020 from Rs. 2,089.4 crore on account of improved sales realisation from its products, coupled with healthy growth in sales volume. However, on a provisional basis, the union recorded only ~Rs. 1,412 crore in 9M FY2021 owing to the pandemic-induced lockdown, leading to significant decline in demand from institutional buyers. Further, BAMUL's operations are mainly concentrated in Bangalore and Ramanagara districts and limited geographical presence would remain critical for revenue growth. The growth is expected to revive, going forward, as demand revival continues.

### Credit challenges

**Modest operating margin, vulnerable to product prices –** Under the cooperative nature of operation, the union's margins remain relatively modest as it endeavours to pass on benefits in various forms to the farmers. The operating margin remained low at 2.9% in FY2020 (albeit improved from 2.4% in FY2019). On a provisional basis, the union recorded inventory devaluation losses from April 2020 to September 2020 on the back of falling prices of WMP and SMP. Nevertheless, the prices have been rising over the last few months enabling the union to recoup its losses. Moreover, it has utilised available earmarked infrastructure and trade fluctuation funds to partially fund these losses. While the margins for the year are expected to remain weaker in FY2021 leading to weaker debt coverage, the same will be supported by a favourable repayment schedule and limited indebtedness.

**Intense competition in dairy industry –** BAMUL is exposed to intense price competition, which restricts its profitability margins to a large extent. Typically, the selling price of milk and milk products are fixed by KMF every two years, whereas the procurement price of milk is fixed by the respective milk unions and are subject to revision on a bi-annual basis. However, given that BAMUL is part of a cooperative structure, with farmers being members of the milk unions, it maintains control on the procurement prices and profitability margins to a large extent. Nevertheless, the union, like all dairy players, is exposed to volatility in global milk powder prices and any adverse movement in the prices could result in weak profitability or high inventory positions.

**Susceptibility to changes in government regulations, and environmental conditions –** BAMUL's revenue, like all dairy players, is susceptible to government regulations such as ban of SMP exports in the past, Covid-19 pandemic-induced lockdown leading

to closure of restaurants, hotels, etc, and the country faced excess supply of milk, which in turn led to decline in SMP prices. In addition, the union is susceptible to adverse milk production conditions resulting from agro-climatic factors such as drought, cattle diseases, etc.

## Liquidity position: Adequate

BAMUL's liquidity has improved supported by sizeable free cash balance, enhanced and undrawn limits as well as limited term debt repayments. The union's free cash flow of operation was negative in FY2020 owing to increase in working capital intensity and higher capex. The working capital requirements remained high in H1 FY2021 with elevated inventory levels and lower-than-expected cash accruals. However, the union received enhancement in its working capital limit to Rs. 200 crore (Rs. 75 crore till July 2020), the average utilisation stood around 61.25% between March 2020 and December 2020. Sizeable free cash balance and undrawn limits support the union's liquidity position. Moreover, it has a small repayment obligation worth Rs. 2.12 crore in FY2021, which will support its near-term liquidity. The major repayment of Rs. 2.08 crore per month will start from the end of December 2021 towards the Kankapura dairy. BAMUL's capex commitments are likely to be deferred after the recent completion of large capacities for Kankapura Powder Plant.

### Rating sensitivities

**Positive factors** – ICRA could upgrade BAMUL's rating if the company demonstrates a sustained improvement in its scale of operations while reviving profitability. Further, the rating could be upgraded if the liquidity position of the union significantly improves than the current levels.

**Negative factors** – Negative pressure on BAMUL's rating could arise if, there is a continued reduction in scale and profitability or a rise in capex leading to weakening of the liquidity position. Specific credit metrics that could lead to a downgrade of BAMUL's rating could be Net Debt/ Adjusted OPBITDA<sup>1</sup> exceeds 1.7 times on a sustained basis.

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a>
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

## About the company

BAMUL was established as Bangalore Dairy on January 23, 1965 with a milk processing capacity of 60,000 litres per day, which was increased multiple times in the subsequent years with the current capacity being 18.0 LLPD. The union has dairy facilities in three locations Mega Dairy with a processing capacity of 10 LLPD, Hoskote Dairy (2 LLPD) and the recently commenced Kanakapura Dairy (6 LLPD). In addition, BAMUL owns six chilling centres with a total capacity of 12 LLPD and bulk coolers of 7.2 LLPD facilitating procurement from the associated DCS. It derives a major portion of the sales through sales to ~1,960 retailers, 81 franchised outlets and 47 own milk parlours through 363 distribution routes. It sells the excess milk and milk products to KMF.

BAMUL reported an OI of Rs. 1412.2 crore in 9M FY2021. When adjusting for infrastructure funds, BAMUL's Profit after Tax (PAT) stood at Rs. 72.6 crore on an OI of Rs. 2534.3 crore in FY2020

<sup>1</sup> Adjusted for infrastructure funds

### Key financial indicators (audited)

BAMUL (Reported)	FY2019	FY2020
Operating Income (Rs. crore)	2089.4	2489.2
PAT (Rs. crore)	25.6	27.5
OPBDIT/OI (%)	2.4%	2.9%
RoCE (%)	8.1%	6.1%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.6
Total Debt/OPBDIT (times)	1.4	2.9
Interest Coverage (times)	8.3	9.6
DSCR (times)	9.1	9.5

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year)

### Status of non-cooperation with previous CRA: Not applicable

India Ratings has withdrawn Bengaluru Urban, Bengaluru Rural & Ramanagara District Co-operative Milk Producer's Societies Union Limited's (BAMUL) bank loan rating of – [IND]BBB (Suspended); withdrawn as on June 19, 2015

Any other information: None

### Rating history for past three years

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
					February 23, 2021			
1	Overdraft	Long term	200.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	-	-
2	Term loan	Long term	-	-	-	[ICRA]BBB+ (Stable)	-	-
3	Interchangeable	Long term/ Short term	(25.00)		[ICRA]BBB+ (Stable)/A2	[ICRA]BBB+ (Stable)/A2		
4	Unallocated	Long term/Short term	-		-	[ICRA]BBB+ (Stable)/A2		

### Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)

*Annexure-1: Instrument details*

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Overdraft	July-2020	NA	NA	100.00	[ICRA]BBB+(Stable)
NA	Cash Credit	July 2020	NA	NA	100.00	[ICRA]BBB+(Stable)
NA	Letter of credit/ Bank Guarantee	Oct-2018			(25.00)	[ICRA]BBB+ (Stable)/ [ICRA]A2

**Source:** Company

*Annexure-2: List of entities considered for consolidated analysis*

Company Name	Consolidation Approach
NA	NA

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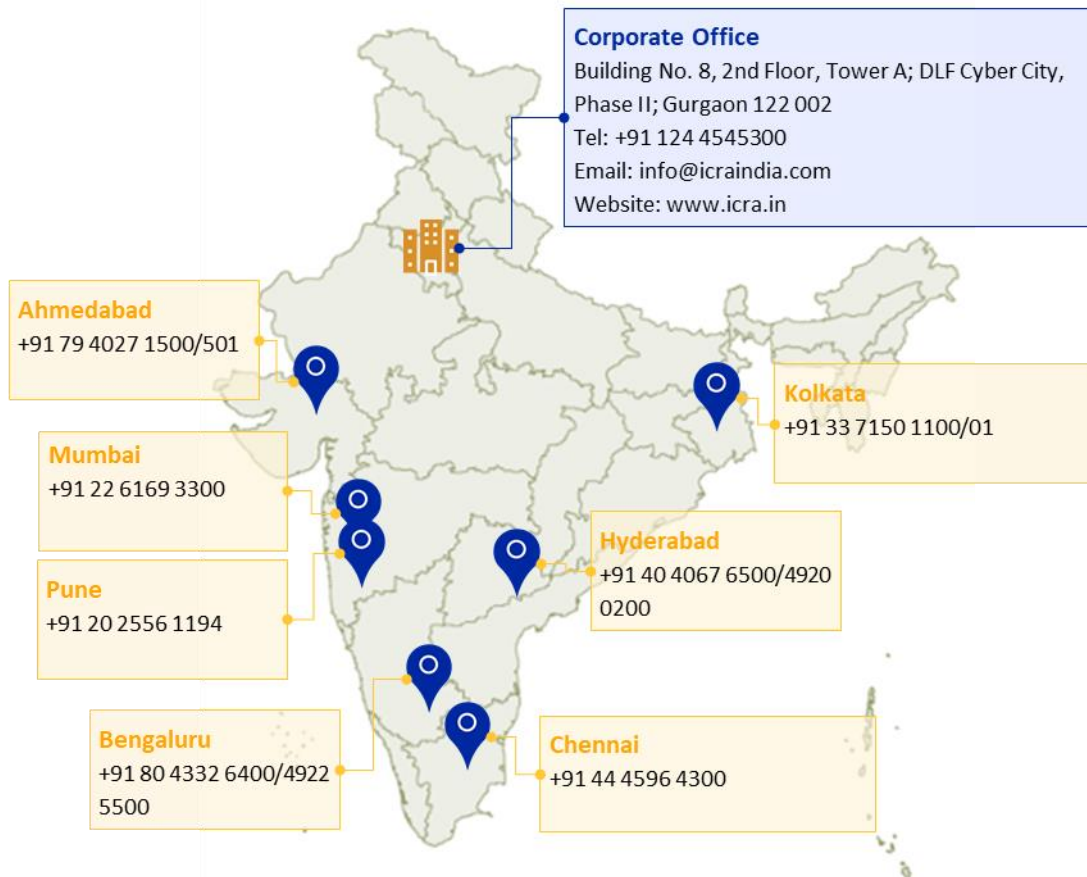
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