October 25, 2022

Mehsana District Co-Operative Milk Producers' Union Limited: Long-term ratings reaffirmed and short-term ratings assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term Loan	40.00	-	-
Long-term Fund-based – Cash Credit/Working Capital Limits	1,560.00	1,570.00	[ICRA]AA+ (Stable); Reaffirmed
Short-term Non-fund Based Limits	-	25.00	[ICRA]A1+; Assigned
Long-term/ Short-term – Unallocated Limits	-	5.00	[ICRA]AA+(Stable); Reaffirmed/ [ICRA]A1+; Assigned
Total	**1,600.00**	**1,600.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation for Mehsana District Cooperative Milk Producer’s Union Limited (Dudhsagar/ the union) continue to reflect its status as a leading dairy processing unit (DPU) under Gujarat Co-operative Milk Marketing Federation (GCMMF), which is the apex marketing federation with significant pricing power in the domestic market. ICRA notes that the union provides assured inventory off-take to its DPUs. The rating also considers the robust procurement arrangement under the cooperative model in Mehsana (Gujarat), which ensures regular supply of milk to the union by village cooperative societies (VCS). In addition, Dudhsagar has an arrangement for procuring milk from non-VCS members outside Gujarat, which ensures uninterrupted supply of raw milk throughout the year. Furthermore, under the cooperative model DPUs maintain control over milk prices by the dual price payment mechanism wherein milk is purchased at provisional prices from VCS throughout the year and most of the pool price is distributed to farmers at the end of the year; although the union has the flexibility to retain funds.

The ratings, however, remain constrained by the average financial risk profile of the union characterised by modest profitability and resultant coverage indicators along with a moderate net worth base. This is attributable to the nature of the dairy cooperative business model wherein most of the operating surplus is passed on to milk producers, leading to limited retention of profits in the business. Also, the union is planning to undertake a sizable capex in the near-term to enhance its production capabilities in the ultra-high temperature (UHT) milk and milk powder division based on the production planning indicated by GCMMF, hence, the level of utilisation of the plant after the project is completed will largely depend on the offtakes by GCMMF. Further, the capex will be largely funded by debt, hence it is likely to impact the capital structure and coverage indicators to an extent in the near term. The ratings also remain constrained by the low utilisation of installed capacities of plants outside Gujarat, which impacts its return indicators to an extent. The ratings continue to factor the union’s exposure to agroclimatic and environment risks, disease outbreaks among livestock, and regulatory changes, which could have a material impact on its dairy operations. ICRA also notes the sizable contingent liabilities pertaining to the buffalo cess of ~Rs. 243 crore levied by the State Government of Haryana as of FY2022. Dudhsagar has challenged the jurisdiction of the state to levy such a cess and the matter is currently sub judice. Any unfavourable outcome on this matter remains critical from a credit perspective, given the large value at dispute. The smooth management of the liability in case of materialisation will remain a monitorable.

The Stable outlook on the long-term rating reflects ICRA's expectation that Dudhsagar will continue to benefit from its strong milk procurement capability, established dairy operation and its continued strategic importance to GCMMF. The revenue is expected to witness stable growth over the medium term, while profitability would continue to remain moderate.

Key rating drivers and their description

Credit strengths

Established market position driven by important standing in cooperative value chain of GCMMF – Dudhsagar is one of the leading unions among the 18 milk unions under GCMMF and has an aggregate milk processing capacity of up to 50 lakh litres per day (LLPD). Dudhsagar contributed ~12% to GCMMF's total income during FY2022. Through its unions, GCMMF has built a cooperative structure with a strong milk collection base of over 35 lakh farmers from more than 18,500 villages. It commands a significant market share in the Indian dairy industry and largely controls the prices of milk and milk products in India. Dudhsagar, hence, derives significant financial flexibility as part of the GCMMF cooperative structure. Further, under the cooperative model, GCMMF's DPUs maintain control over raw milk prices by the dual price payment mechanism wherein milk is purchased at provisional prices from VCS throughout the year and most of the pool price is distributed to farmers at the end of the year; although the union has the flexibility to retain funds.

Established milk procurement system from VCS under cooperative model alongside milk procurement arrangement with non-VCS members outside Gujarat de-risk milk availability issues – Dudhsagar has an established milk procurement system under its cooperative model in Mehsana, which ensures regular supply of milk to the district union by VCS. Also, Dudhsagar has an arrangement for procuring milk from non-VCS members outside Gujarat, which ensures uninterrupted supply of raw milk throughout the year.

Geographically diversified presence with two dairy processing units in North India – Dudhsagar owns six dairy plants in and around Mehsana with a combined processing capacity of 33 LLPD, along with two plants in Haryana (Manesar and Dharuhera) with a capacity of 10 LLPD each. The union also owns chilling plants across Rajasthan, Haryana and Uttar Pradesh in addition to its processing facilities. Dudhsagar's geographically diversified presence provides operational flexibility in terms diversified revenue stream and a strong milk procurement arrangement.

Favourable dairy industry growth prospects – 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 are other positive factors.

Credit challenges

Moderate financial risk profile; planned debt-funded capex to keep coverage numbers under check in near to medium term – Despite its long operational history, its large scale of operation and a strong business risk profile, Dudhsagar has an average financial risk profile characterised by a relatively moderate net worth, leverage capital structure, modest operating profitability level and consequent moderate coverage indicators. The union follows a business model, wherein the price differential for their milk supply is paid to members at the end of the year. Further, Dudhsagar is planning a large debt-funded capex for modernisation and expansion of its UHT capacity, which is expected to be over by FY2024. Though the same is expected to improve operational efficiencies and increase capacity for UHT milk, the coverage metrics is expected to remain under check in the near to medium term. However, healthy financial flexibility and adequate liquidity from the assured offtake from GCMMF supports its credit profile.

Below optimum utilisation of milk processing capacities of plants located outside Gujarat – Dudhsagar's plants in Haryana have been operating at below optimum capacity levels of ~27-35% of their installed processing capacity for many years now. The capacity utilisation of the plants also varies from the production schedule given by GCMMF to the union. At an aggregate level, the union's capacity utilisation has been in the range of 58% in FY2022 over 56% in FY2021. Despite the improvement in capacity utilisation, the capacities remained moderately utilised during the year.

Exposure to volatile product prices and regulatory changes along with external factors like weather and disease outbreaks – The union is exposed risk related to agroclimatic factors, such as droughts, and disease outbreaks leading to increase in cattle diseases, which may adversely impact milk production and have a significant material impact on its dairy operations. The same is also being witnessed in the current fiscal with the emergence of the lumpy disease that has affected milk supply in H1 FY2023.

Sizable contingent liabilities largely pertaining to Haryana Murrah Buffalo Cess – The union has a sizable contingent liability pertaining to the Haryana Buffalo Cess. The said milk cess was started in 2001 by the State Government of Haryana under the Haryana Murrah Buffalo and Other Milch Animals Breed (Preservation and Development of Animal Husbandry and Dairy Development Sector) Act, 2001. The cess is applicable to milk processing plants in the state. The contingent liability of the cess as of FY2022 end stood at ~Rs. 243 crore, over ~Rs. 184 crore as of FY2021. Dudhasagar has challenged the jurisdiction of the state to levy such a cess and the matter is currently sub judice. Any unfavourable outcome on this matter remains critical from credit perspective, given the large value at dispute, and smooth management of the liability in case of materialisation will remain a monitorable.

Liquidity position: Adequate

Dudhsagar has adequate liquidity since it is paid by GCMMF on a daily basis and suppliers are paid every 10 days. Further, the average working capital utilisation remained at ~75% of the union's drawing power and ~35% of the sanctioned limits over the last 15 months ending July 2022, resulting in moderate cushion in terms of unutilised limits. Dudhsagar has moderate repayment obligations of ~Rs. 58 crore in FY2023; although it will increase from FY2024 due to its debt-funded capex plans. Dudhsagar passes back the surplus to farmers at the end of the year in the form of price differences, which stood at Rs. 321 crore in FY2022. This is provided from the surplus after meeting all obligations of the union, which provides much needed flexibility to the management.

Rating sensitivities

Positive factors – Any near to medium term rating upgrade is constrained given the almost sole dependence of Dudhsagar on GCMMF for product offtake and brand positioning.

Negative factors – Downward pressure on the rating could emerge if there is significant drop in sales as well as realisations leading to reduction in profitability, impacting return and coverage indicators, or any material weakening of the liquidity position. Downward pressure could also emerge if there is a weakening of the credit profile of GCMMF or reduced strategic importance of the union for GCMMF.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Parent/Group Support
Parent/Group support	The rating assigned to Dudhsagar factors in the high likelihood of GCMMF extending financial support to it because of the cooperative structure and GCMMF being the apex marketing federation for all unions in Gujarat. Further, most of Dudhsagar's sales is routed through GCMMF and, hence, given the close business linkages between them, ICRA expects GCMMF to be willing to extend financial support to Dudhsagar to protect its reputation from the consequences of a union's distress.
Consolidation/Standalone	Standalone

About the company

Incorporated in 1960, Dudhsagar is a cooperative district producers' milk union established under the three-tier cooperative structure of Gujarat, known as the Anand Pattern. Dudhsagar procures milk from around 1,240 member VCS of around 6.1 lakh farmers, who hold the entire shareholding in Dudhsagar. It had a total milk processing capacity of 53 LLPD as on March 31, 2022 from its dairy plants in Gujarat and Haryana.

Key financial indicators (audited)

Dudhsagar Standalone*	FY2021	FY2022
Operating income	5,012	6,029
PAT	257	340
OPBDIT/OI	7.1%	6.7%
PAT/OI	5.1%	5.6%
Total outside liabilities/Tangible net worth (times)	2.9	2.9
Total debt/OPBDIT (times)	2.8	1.9
Interest coverage (times)	4.9	7.1

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

**ICRA Adjusted Numbers*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Oct 25, 2022	July 29, 2021	April 02, 2020	-
1	Term loan	Long term	-	-	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-
2	Cash Credit/Working capital Limits	Long term	1,570.00	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-
3	Non-Fund based limits	Short term	25.00	-	[ICRA]A1+	-	-	-
4	Unallocated limits	Long term and short term	5.00	-	[ICRA]AA+ (Stable)/ [ICRA]A1+	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit/Working capital Limits	Simple
Short-term Non-Fund based limits	Very Simple

Long-term/Short-term – Unallocated limits	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit/Working capital Limits	NA	NA	NA	1,570.00	[ICRA]AA+ (Stable)
NA	Non-Fund based limits	NA	NA	NA	25.00	[ICRA]A1+
NA	Unallocated limits	NA	NA	NA	5.00	[ICRA]AA+ (Stable)/ [ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not Applicable

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545 328
shamsherd@icraindia.com

Srikumar Krishnamurthy
+91 9884086366
ksrikumar@icraindia.com

Suprio Banerjee
+91 9820244979
supriob@icraindia.com

Srinivas Menon
+91 9167322924
srinivas.menon2@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.