July 31, 2024

Karnataka Co-Operative Milk Producer's Federation Limited: Ratings downgraded to [ICRA]A (Stable) / [ICRA]A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based/ cash credit	70.0	70.0	[ICRA]A (Stable); downgraded from [ICRA]A+(Stable)
Short-term – Interchangeable	(30.0)	(30.0)	[ICRA]A1; downgraded from [ICRA]A1+
Long-term/ Short-term – Unallocated	30.0	30.0	[ICRA]A (Stable)/ [ICRA]A1; downgraded from [ICRA]A+(Stable)/ [ICRA]A1+
Total	**100.0**	**100.0**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade considers Karnataka Co-Operative Milk Producer's Federation Limited's (KMF) weaker-than-anticipated performance in FY2024, marked by a decline of 3.0% in revenues and 110 bps contraction in operating margins and expectations of moderate recovery in FY2025. The Federation's revenues in FY2024 were impacted by reduced milk availability in the state, which impacted the sales volumes of milk and milk products, while cattle feed sales witnessed a modest growth. The Federation's margins were impacted by increased cost of cattle feed production, on account of elevated raw material costs, which could not be passed on to farmers and decline in skimmed milk powder (SMP) and butter prices. Milk availability has increased in Q1 FY2025 on account of improved cattle farming and better yield, given the favourable monsoons and hike in SMP prices, thus supporting its revenues. KMF's ability to take periodic price corrections on sales of milk and feed to protect its margins remains a monitorable. The ratings also consider KMF's support in the form of ~Rs. 800 crore corporate guarantees for the working capital limits availed by milk unions in Karnataka.

The ratings, however, remain supported by the long track record and dominant market position of KMF in the dairy industry. KMF is strategically important to the Central and state governments as it is the largest dairy cooperative in Karnataka; hence, its operations are supported by various Government schemes and grants. The ratings consider KMF's diversified product portfolio, which includes milk and milk products under its established brand 'Nandini', as well as cattle feed. Further, KMF has built a robust procurement network with 15 unions, which have an established base of dairy farmers. Healthy demand for milk and milk products and growing demand for its products from neighbouring states, augur well for its growth prospects. KMF's standalone debt coverage indicators continue to be comfortable with interest coverage of 21.9 times and DSCR of 3.1 times in FY2024. The Federation avails term loans from the National Dairy Development Board (NDDB) at lower interest rates, which support the coverage metrics.

The ratings remain constrained by the commoditised nature of operations, and high competition from organised cooperatives, private dairies, and unorganised players. Also, milk production remains vulnerable to external factors such as weather conditions and cattle diseases, along with Government-imposed regulations. The ratings also consider KMF's lower profitability given the nature of the dairy cooperative model, which focuses on passing on benefits to unions and farmers. KMF's earnings are vulnerable to fluctuations in input costs due to its limited pricing flexibility, as price revisions are subject to approvals from the Government, unlike private dairies.

The Stable outlook on the rating reflects ICRA's opinion that KMF's credit profile will remain stable, supported by its dominant market position and strategic importance to the Government. The increase in demand for milk and milk products due to rising disposable income and health consciousness supports the demand outlook.

Key rating drivers and their description

Credit strengths

Market leadership in Karnataka backed by an established procurement chain – KMF is the apex body for the dairy cooperative movement in Karnataka. KMF is the second-largest dairy cooperative in the country. At present, KMF and its 15-member cooperative milk unions procure 80-85.0 lakh litres per day (LLPD) (would be higher during flush season) of raw milk under the dairy cooperative model, with the federation being associated with 26.9 lakh milk producer members across Karnataka through more than 15,000 dairy cooperative societies covering more than 23,000 villages. KMF has an installed capacity of ~320 MT/day to process raw milk into milk powder. To meet the unions' pouch film demand, KMF has established a pouch film plant with a capacity of 9 MTPD. It also owns five cattle feed plants and sells the same to milk producers via unions.

Diversified revenue and wide product range of milk and milk products – KMF's product portfolio includes cattle feed/fodder, milk, buttermilk, curd, cream, butter, *ghee* (clarified butter), skimmed milk powder (SMP), whole milk powder (WMP), flavoured milk, milk-based sweets, chocolates, ice creams, etc. From a pure-play liquid milk brand, KMF has expanded into milk derivatives, and all the products are sold under the brand, '*Nandini',* which has an established presence in its target markets. KMF's revenue is diversified with the sale of milk and milk products accounting for ~51%, cattle feed for 35%, skimmed milk powder (SMP) for 11% and the rest of the revenues is generated from conversion charges and pouch film. The federation markets milk and milk products produced in-house and by the 15 milk unions in Karnataka and outside the state. The federation owns 10 sales depots in Karnataka and eight outside the state. KMF revised the milk price by Rs. 2 per litre in July 2023; however, the same was passed on to farmers with an increase in procurement prices.

Standalone credit profile remains healthy although guarantees extended to milk unions constrain debt metrics - KMF's standalone debt coverage indicators are comfortable with interest coverage of 21.9 times, total debt/OPBDITA of 8.3 times and DSCR of 3.1 times in FY2024. KMF plans to incur capex of Rs. 250-300.0 crore in FY2026 towards setting up a pouching plant, which will be funded through a mix of term loan and internal cash accruals. Its standalone coverage indicators are expected to remain healthy, despite the debt-funded capex plans. KMF also provides support in the form of ~Rs. 800 crore corporate guarantees for the working capital limits availed by milk unions in Karnataka. The debt indicators moderated for the same with adjusted net debt to OPBDITA at 5.7times in FY2024.

Importance of sector to state government – At present, the Government of Karnataka (GoK) provides a milk purchase subsidy of Rs. 5.0/litre of procured milk to the farmers through KMF's member cooperative milk unions. Further, the GoK has provided various grants to unions and milk producers cooperative societies (MPCS) through KMF, to encourage capacity expansion and training. Apart from grants and incentives (directly to farmers), KMF's revenue base benefits from Government schemes for selling milk and milk products. KMF's strategic importance to the state lends stability to revenues and cash flows.

Credit challenges

Moderation in FY2024 revenue; vulnerable to cattle feed and raw material procurement costs – KMF's revenues declined to Rs. 5,951.0 crore in FY2024 from Rs. 6,136.5 crore in FY2023, owing to decline in sales of milk and milk products. Lower rainfall (impacting the yield) has affected the milk availability, leading to contraction in sales. Milk procurement declined to 82.5 LLPD in FY2024 from 83-85 LLPD in FY2023 on account of reduced availability, which also impacted the Federation's sales. Under the cooperative nature of operations, the federation's margins remain relatively modest as it endeavours to pass on benefits in various forms to the farmers. These include favourable procurement prices and discounts on cattle feed, among others. The federation also supports the unions with grants for capex requirements or need-based working capital support. The OPM of the Federation has declined to 1.7% in FY2024 from 2.8% in FY2023 owing to high cattle feed production costs which were not passed on to farmers. While the increase in SMP prices and planned hike in cattle feed prices in the current year are expected to support KMF's margins, its ability to take periodic price corrections to protect its margins remains a monitorable.

Intense competition in dairy industry – KMF is exposed to intense competition, which restricts its profitability margins to a large extent, despite its leadership position in Karnataka. Typically, the selling prices of milk are fixed by KMF with consultation from the GoK, which renders the federation with low bargaining power on the procurement prices of milk. On the other hand, private dairies procure milk based on the end-market prices, thereby, often providing an edge over dairy cooperatives.

Susceptibility to changes in Government regulations and environmental conditions – KMF's revenue, like all dairy players, is susceptible to Government regulations such as the ban of SMP exports in the past. In addition, the federation is also susceptible to adverse milk and cattle feed production conditions resulting from agro-climatic factors such as drought and cattle diseases, as seen in lumpy skin disease (LSD) in FY2023.

Liquidity position: Strong

KMF's liquidity position is **strong,** on the back of healthy free cash and bank balances of Rs. 280-320.0 crore as on June 30, 2024, and a buffer of Rs. 70.0 crore in working capital limits against repayment obligations of Rs. 30-35.0 crore over the next 12 months. In addition, the federation has capex plans of Rs. 80-120 crore in FY2025, which will be funded through internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade KMF's ratings, if there is a significant improvement in its profitability metrics and an improvement in the GoK's credit risk profile.

Negative factors – Pressure on KMF's ratings could arise, if there is a significant drop in its earnings, or if debt metrics or liquidity position weaken due to significant increase in support to unions or debt-funded capex. A specific credit metric for a downgrade would be the DSCR falling below 2.1 times, on a sustained basis. Any deterioration in the credit profile of the GoK could also put pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered KMF's standalone financials while adjusting its debt for the CG extended to the milk unions.

About the company

KMF is the apex body for the dairy cooperative movement in Karnataka. KMF is governed as per the Karnataka Cooperative Societies Act, 1959, and has 15 milk union members. It is the second-largest dairy cooperative in the country. The main function of the federation is to regulate the milk supply across its member unions to combat inadequate milk supply in certain districts within Karnataka, and market the milk products manufactured by the unions under its '*Nandini*' brand. KMF owns 18 sales depots, and the federation is associated with more than 23,000 retailers and over 600 wholesale distributors operating across India. In 1975, the Karnataka Dairy Development Cooperation (KDDC) was set up to organise village-level dairy production and procurement on a cooperative basis, with financial assistance from the World Bank/International Development Agency. KDDC was converted to KMF in 1984 and dairy development activities were extended to cover the entire state under Operation Flood II. The state federation, KMF, has 15 milk unions across Karnataka covering 30 districts. The unions operate with individual dairy processing facilities and chilling centres catering to the nearby districts.

Key financial indicators (audited)

Standalone	FY2023	FY2024*
Operating income	6136.5	5951.0
PAT	91.2	36.0
OPBDIT/OI	2.8%	1.7%
PAT/OI	1.5%	0.5%
Total outside liabilities/Tangible net worth (times)	1.6	1.5
Total debt/OPBDIT (times)	5.1	8.3
Interest coverage (times)	26.1	21.9

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amounts in Rs. crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)			Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
				Jul 31, 2024	Apr 10, 2023	Apr 29, 2022	-
1	Cash credit	Long-term	70.0	[ICRA]A (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
2	Interchangeable	Short-term	(30.0)	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	-
3	Unallocated	Long-term/ Short-term	30.0	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund-based - Cash credit	Simple
Short-term – Interchangeable	Very simple
Long-term/Short-term – Unallocated	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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Cash credit**	NA	NA	NA	70.0	[ICRA]A (Stable)
NA	**Interchangeable**	NA	NA	NA	(30.0)	[ICRA]A1
NA	**Unallocated**	NA	NA	NA	30.0	[ICRA]A (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

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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.

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