

April 10, 2023

Karnataka Co-Operative Milk Producer's Federation Limited: Ratings reaffirmed

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) reaffirmed
Short-term – Interchangeable	(30.0)	(30.0)	[ICRA]A1+ reaffirmed
Long-term/ Short-term – Unallocated	30.0	30.0	[ICRA]A+(Stable)/[ICRA]A1+ reaffirmed
Total	100.0	100.0	

*Instrument details are provided in Annexure-I

Rationale

The ratings factor in the long track record and dominant market position of Karnataka Co-Operative Milk Producer's Federation Limited (KMF/ the federation) 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. KMF witnessed healthy revenue growth over the past two years on the back of healthy demand for milk and milk products and growing demand for its products from neighbouring states. However, KMF's revenue growth is expected to moderate by 3-5% in FY2023 owing to a slowdown in procurement. Further, KMF's financial profile continues to be comfortable with a healthy capital structure, coverage indicators, and liquidity position.

The ratings are, however, constrained by KMF's lower profitability given the nature of the dairy cooperative model, which focuses on passing on benefits to unions and farmers. The company's earnings are vulnerable to fluctuations in input costs given its limited pricing flexibility as price revisions are subject to approvals from the Government, unlike private dairies. KMF's milk procurement has been low in Q4 FY2023 as the lower selling price has limited KMF's ability to increase its procurement price (paid to farmers for raw milk) compared to other dairies. Moreover, lumpy skin disease has also impacted the supply. Hence, KMF's revenues are expected to contract by 3-5% in FY2023. However, ICRA expects revenues to recover by 6-8% in FY2024 with increased supply and procurement of milk. KMF's margins are expected to moderate by 80-100 bps in FY2023 owing to higher input costs. While margins are expected to improve in FY2024 given the planned pricing actions, ICRA expects the margins to be lower than FY2022 levels. The ratings are also 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, and Government-imposed regulations.

The Stable outlook reflects ICRA's opinion that KMF will continue to maintain its dominant market position and receive assistance from the Government due to its strategically important position. Moreover, the Indian dairy industry is expected to continue to grow on the back of a steady supply of milk, with India being the world's largest milk producer. The increase in demand for milk and milk products due to rising disposable income and increasing health consciousness also supports the demand outlook.

Key rating drivers and their description

Credit strengths

Market leadership in Karnataka backed by a well-entrenched procurement chain – KMF is one of the largest entities operating in the dairy industry in South India. At present, KMF and its 15-member cooperative milk unions procure ~82.6 lakh litres per day (LLPD) of raw milk under the dairy cooperative model, with the federation being associated with ~25.3 lakh milk producer members across Karnataka through more than 15,000 dairy cooperative societies covering more than 23,000 villages. The respective milk unions own chilling capacities to store milk totalling 29.5 LLPD and bulk milk coolers to store up to 51.0 LLPD to maintain the cold chain. 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. KMF is estimated to have market share of more than 30% of the aggregate milk production in Karnataka.

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. Apart from revenue through the sale of cattle feed (21% of revenues in FY2022) 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, expanding the network with interstate sales account for around 15% of the revenue.

Comfortable financial risk profile – KMF's financial profile continues to be comfortable with a healthy capital structure and debt metrics. KMF's debt reduced to Rs. 114.7 crore as on March 31, 2022, and further to Rs. 90.3 crore as on December 31, 2022, which mainly included capex loans from the National Dairy Development Board (NDDB). KMF's coverage indicators were comfortable with interest coverage at 24.4 times (18.8 times in 9M FY2023), TOL/TNW at 1.6 times, and NCA/TD at 116.9% in FY2022 (137.2% in 9M FY2023). Despite the expected moderation in debt metrics in FY2023 owing to lower margins, its capital structure and coverage metrics are expected to remain healthy. KMF had plans to incur capex of about Rs. 100-120 crore per annum for the next three years towards adding capacities at existing plants and adding new cattle feed plants, which will be funded through internal cash accruals and available cash and liquid investments that are expected to drive revenue growth, going forward. In addition, the capital structure and coverage indicators are expected to remain healthy.

Importance of the sector to Central and state governments – At present, the State 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 provides various grants to unions and milk producers cooperative societies (MPCS) via KMF, mainly 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. ICRA notes that the federation will receive grants for the proposed capital expenditure (capex) in the medium term. The strategic importance of KMF as the milk federation of the state is a rating comfort.

Credit challenges

Modest operating margins; vulnerable to cattle feed and raw material procurement costs – 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 operating margin moderated to 2.0% in 9M FY2023 from 3.2% in FY2022 and 4.6% in FY2021 owing to the increase in the cost of manufacturing cattle feed. This was due to higher maize prices and the increase in milk procurement prices, while the increase in selling price

was not commensurate with the increase in procurement prices. The operating profits are expected to improve over the medium term with the expected increase in prices of milk and milk products; however, the same will remain constrained by increasing procurement prices and the cooperative nature of operations.

Intense competition in the dairy industry – KMF is exposed to intense price 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 skimmed milk powder (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

The liquidity continues to be **strong** on the back of healthy free cash and bank balances of ~Rs. 350-375 crore as on March 30, 2023, and a buffer of Rs. 70.0 crore in working capital limits against repayment obligations of ~Rs. 30.0 crore over the next 12 months. In addition, the federation has capex plans of about Rs. 120-140 crore per annum and will be funded through internal accruals only.

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 its liquidity position weakens due to higher-than-anticipated support to unions or debt-funded capex. A specific credit metric for a downgrade would be the DSCR falling below 2.5 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 the standalone financials of KMF.

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

	FY2021	FY2022	9M FY2023*
Operating income	5356.2	6675.7	4858.9
PAT	161.3	124.0	49.3
OPBDIT/OI	4.6%	3.2%	2.0%
PAT/OI	3.0%	1.9%	1.0%
Total outside liabilities/Tangible net worth (times)	1.4	1.6	ND**
Total debt/OPBDIT (times)	0.6	0.5	ND**
Interest coverage (times)	20.3	24.4	18.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. Crore; ND = No data available for 9M FY2023**; Source: Company, ICRA Research; * Provisionals for 9M FY2023; All ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years			
		Amount rated (Rs. crore)	Amount o/s as of Feb 28, 2023 (Rs. crore)	Date & rating in FY2024	FY2023	FY2022	FY2021
				Apr 10, 2023	Apr 29, 2022	-	Jan 29, 2021
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

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

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