Detailed Rationale & Key Rating Drivers
The revision in the ratings assigned to the bank facilities of Mehsana District Cooperative Milk Producer’s Union Ltd (MDCMPUL, the union) is on account of significant increase in its working capital borrowings during FY18 and 10MFY19 on a sustained basis primarily on account of increase in inventory levels [mainly Skimmed Milk Powder (SMP)].

The ratings, however, continue to derive strength from its established operations as one of the largest unions of Gujarat Co-operative Milk Marketing Federation Ltd (GCMMF; rated CARE A1+) with well recognized brands ‘Amul’ and ‘Sagar’. The ratings also continue to factor in union’s geographically diversified revenue stream with own milk processing facility outside Gujarat, its strong milk procurement network within and outside Gujarat and measures undertaken to enhance milk production.

The long-term rating, however, continues to be constrained by risks associated with milk supply along with geographically concentrated milk procurement and exposure to highly volatile SMP prices & regulatory changes. The ratings are further constrained on account of moderate utilization of its milk processing capacities due to lower than envisaged utilization of some of its large capacity addition in the recent years.

Any environment, epidemic-related factors or regulatory changes having a significant impact on the union’s operations for a longer term, any adverse changes in the Amul cooperative structure, any adverse movement in SMP prices having material impact on the union’s profitability, extent of returns to farmers, optimal utilization of the existing milk processing capacities to increase its scale of operations along with better inventory & working capital management resulting in significant reduction of its existing debt levels shall be the key rating sensitivities. Any significant debt-funded capex or further increase in its working capital borrowings adversely impacting its capital structure and debt coverage indicators shall be additional rating sensitivities. Further geographical diversification of the milk procurement base shall also be a key rating monitorable.

Detailed description of the key rating drivers
Key Rating Strengths

**Strong apex marketing federation of GCMMF which possesses significant pricing power**
MDCMPUL is one of the significant contributing member Dairy Processing Units (DPUs) amongst the 18 member DPUs of GCMMF; as indicated by its 15% contribution to GCMMF’s total income during FY18 (refers to the period April 1 to March 31); albeit its share in GCMMF’s total income has declined from 18% in FY17.

GCMMF has established the brands ‘Amul’ and ‘Sagar’ as the leading dairy brands in India and facilitates decision making of its member DPUs. GCMMF, through its DPUs built on a cooperative structure, has a strong milk collection base of over 35 lakh farmers spread across 18,554 villages and the daily milk collection of all member DPUs aggregates around 204 lakh litres per day (LLPD). Furthermore, with a collective milk processing capacity of 360 LLPD, GCMMF commands a significant market share in the Indian dairy industry.

GCMMF has a significant share in the Indian organized dairy industry and thereby possesses strong pricing power for its products and largely heralds the prices of milk and milk products in the country. Furthermore, GCMMF and its DPUs also have control on the raw material pricing with a robust cash flow mechanism in the structure with aim of passing on remunerative returns to farmer members. MDCMPUL also derives financial flexibility by virtue of being part of the GCMMF co-operative structure.
Geographically diversified revenue stream; albeit relatively stagnant TOI over past few years

MDCMPUL's revenue stream is geographically diversified with around 40% of its sales generated from outside Gujarat. Besides Gujarat, the union has its milk processing capacities in north India. Milk for these units is supplied by MDCMPUL through its own procurement in Gujarat and from non-member Village Cooperative Society (VCS) network in Haryana, Jaipur, Ajmer and other surrounding regions of Rajasthan. The union's milk procurement increased y-o-y by 11% in FY18 to 99 crore kg, which was mainly on account of higher procurement from outside Gujarat.

However, MDCMPUL's total operating income decreased y-o-y by 5.10% in FY18 to Rs.4,282 crore, on account of lower realization for packaged milk due to revision in the prices of packaged milk and various other products on the back of GST implementation during FY18 and lower liquidation of its SMP inventory. The union, however, has plans to address these issues by gradually increasing the share of sales under its own ‘Sagar’ brand in some of its geographies going forward. During 10MFY19, as per provisional figures, MDCMPUL has achieved a TOI of ~Rs.3,884 crore.

Although, the union’s management has articulated its stance to not undertake any major debt-funded capex in the medium term, it does plan to undertake capex towards setting-up a paneer and cheese manufacturing plant at its Kadi plant towards achieving greater product diversification in its sales mix.

Favourable dairy industry growth prospects

The Indian dairy industry grew at a compounded annual growth rate (CAGR) of around 15% over the past five years ended 2018 and is expected to continue to grow at CAGR of 12-13% over next three years, on the back of steady supply of milk with India being world’s largest milk producer and increase in demand for milk and milk products due to rising disposable income and increasing health consciousness.

In the interim budget of 2019, announcement of 2% interest subvention for farmers availing loan through the Kisan Credit Card scheme and engaged in animal husbandry and fisheries; and further 3% additional interest subvention in case of timely repayment of loan alongwith increase in the outlay for Rashtriya Gokul Mission to Rs.750 crore and setting up of Rashtriya Kamdhenu Aayog to upscale sustainable genetic upgradation of cow resources, enhance production and productivity of cows are expected to increase milk productivity and its production in the country.

Moreover, beginning July 1, 2018, the Government of Gujarat announced subsidy on export of 60,000 tonne SMP for the next six months with a cap of Rs.300 crore, thus resulting into a subsidy of Rs.50/kg and Rs.5/litre of milk to dairies that do not opt for export subsidy, to be paid to the farmers. Furthermore, Government of Maharashtra has extended the subsidy of Rs.5/litre of milk on export of SMP, which ended on November 1, 2018, by three more months and the central government has increased the export subsidy benefit on milk and milk products from 10% to 20%. The introduction of these subsidies narrow the gap between the cost of production of SMP and its selling price, thus giving the dairies the incentive to export and helping them reduce the inventory levels of SMP.

The dairy industry, however, remains exposed to volatility in prices of products such as SMP due to its linkages with international markets, along with probable regulatory changes such as ban on export of SMP and demand for signing of free trade agreements by major milk producing countries.

Key Rating Weaknesses

Significant increase in inventory and debt levels

The operating cycle of the union increased from 41 days in FY17 to 66 days in FY18 primarily on account of increase in inventory levels. The union’s closing inventory increased from Rs.544 crore as on March 31, 2017 to Rs.992 crore as on March 31, 2018 wherein SMP inventory was ~27,000 MT as on even date. The SMP inventory levels were high mainly due to in

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Press Release

capacities has resulted in continued moderate utilisation of these capacities, averaging at 48% in FY18 (49% in FY17; 50% in FY16).

Exposure to volatile product prices and regulatory changes
The Indian dairy industry remains exposed to high volatility in prices of products such as SMP due to its linkages with international markets, along with probable regulatory changes such as ban on export of SMP and demand for signing of free trade agreements by major milk producing countries. Further, the demand for dairy analogues, which are used as a substitute for milk and milk fat, are causing a major threat as they are look-alike dairy products and provide significant cost-cutting opportunities. Furthermore, the industry remains fragmented with presence of large number of players. This apart, the industry also remains exposed to volatile product prices such as price of SMP, which is exported from India and hence the domestic price is affected by the global demand-supply balance and the resultant volatility in the international price. Further, the demand for dairy analogues, which are used as a substitute for milk and milk fat, are causing a major threat as they are look-alike dairy products and provide significant cost-cutting opportunities.

Exposure to environment-related risks with geographically concentrated milk procurement
DPUs such as MDCMPUL are exposed to environmental risk, such as epidemic, associated with concentration in milk collection, since most of the milk procurement is from one district and its surrounding villages. MDCMPUL has built up its milk procurement network outside Gujarat with non-member VCS; however, 69% of its total milk procurement in FY18 was from its milk shed area in Gujarat, which exposes it to risks associated with concentration in milk collection.

Liquidity Analysis
The union’s utilization of its fund based working capital limits was moderately high at around 83% for the 12 months ended January, 2019. However, the union derives comfort from sales being made on ‘cash and carry’ basis with daily receipts from GCMMF, while provisional payment to VCS is being made at every 10 days interval. Further, union has the flexibility to change the prices paid to the farmers as the surplus available with DPU is passed on to VCS only after considering reasonable amount for its debt repayments, capital expenditure and operational expenses. Furthermore, it had free cash and bank balance of Rs.36.72 crore as on March 31, 2018.

Analytical approach: Standalone along with group support
Milk suppliers (farmer owners) are at the base of the dairy cooperative structure. Profit is not a motive of organizations working under this structure and maximum returns to these farmers are passed on by way of milk procurement prices. Furthermore, the cooperative structure has a robust cash flow mechanism, wherein the Marketing Federation (Gujarat Co-operative Milk Marketing Federation Ltd.; rated CARE A1+) releases funds to its DPUs, and DPUs make payments to VCS which in-turn distribute payment to member farmers for their milk supply. Hence, ratings of such cooperative sector entities are derived on the basis of sustainability and growth of the structure, stability of the milk supply base, trend in milk procurement, distribution network and brand created by the federation and average annual milk procurement prices paid to farmers.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE’s Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology – Factoring Linkages in Ratings
Rating Methodology – Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Union
Incorporated in 1964, MDCMPUL is a co-operative DPU established under the three-tier cooperative structure of Gujarat, known as ‘Anand Pattern’ or ‘Amul Structure’. The union procures milk from around 1,296 member VCS consisting of around 6.12 lakh farmers, which hold the entire shareholding in MDCMPUL. It had total milk processing capacity of 50 LPD as on March 31, 2018 from its dairy plants in Gujarat and Haryana.

<table>
<thead>
<tr>
<th>Brief Financials (Rs. crore)</th>
<th>FY17 (A)</th>
<th>FY18 (A)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total operating income</td>
<td>4,513</td>
<td>4,282</td>
</tr>
<tr>
<td>PBILDT</td>
<td>193</td>
<td>192</td>
</tr>
<tr>
<td>PAT</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Overall gearing (times)#</td>
<td>6.21</td>
<td>8.05</td>
</tr>
<tr>
<td>Interest coverage (times)</td>
<td>1.97</td>
<td>1.77</td>
</tr>
</tbody>
</table>

A: Audited
Press Release

# Calculated after netting off unencumbered fixed deposits from debt

As per provisional results, MDCMPUL has registered net sales of Rs.3,884 crore during 10MFY19.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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**For detailed Rationale Report and subscription information, please contact us at www.careratings.com

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Disclaimer

CARE’s ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CARE has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable. CARE does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

Annexure-1: Details of Instruments/Facilities

<table>
<thead>
<tr>
<th>Name of the Instrument/Facilities</th>
<th>Date of Issuance</th>
<th>Coupon Rate</th>
<th>Maturity Date</th>
<th>Size of the Issue (Rs. crore)</th>
<th>Rating assigned along with Rating Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund-based - LT-Term Loan</td>
<td>-</td>
<td>-</td>
<td>January, 2022</td>
<td>18.03</td>
<td>CARE AA; Stable</td>
</tr>
<tr>
<td>Fund-based - LT/ ST-Cash Credit</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,600.00</td>
<td>CARE AA; Stable / CARE A1+</td>
</tr>
<tr>
<td>Non-fund-based - LT/ ST-BG/LC</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>73.60</td>
<td>CARE AA; Stable / CARE A1+</td>
</tr>
<tr>
<td>Fund-based - LT-Term Loan</td>
<td>-</td>
<td>-</td>
<td>April, 2022</td>
<td>212.10</td>
<td>CARE AA; Stable</td>
</tr>
</tbody>
</table>
**Annexure-2: Rating History of last three years**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Instrument/Bank Facilities</th>
<th>Type</th>
<th>Amount Outstanding (Rs. crore)</th>
<th>Current Ratings</th>
<th>Rating</th>
<th>Date(s) &amp; Rating(s) assigned in 2018-2019</th>
<th>Date(s) &amp; Rating(s) assigned in 2017-2018</th>
<th>Date(s) &amp; Rating(s) assigned in 2016-2017</th>
<th>Date(s) &amp; Rating(s) assigned in 2015-2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Fund-based - LT-Term Loan</td>
<td>LT</td>
<td>18.03</td>
<td>CARE AA; Stable</td>
<td>-</td>
<td>1)CARE AA+; Stable (06-Feb-18)</td>
<td>1)CARE AA+; Stable (31-Dec-16)</td>
<td>1)CARE AA+; Stable (26-May-16)</td>
<td>1)CARE AA+; Stable (11-Dec-15)</td>
</tr>
<tr>
<td>2.</td>
<td>Fund-based - LT/ ST-Cash Credit</td>
<td>LT/ST</td>
<td>1,600.00</td>
<td>CARE AA; Stable / CARE A1+</td>
<td>-</td>
<td>1)CARE AA+; Stable / CARE A1+ (06-Feb-18)</td>
<td>1)CARE AA+; Stable / CARE A1+ (31-Dec-16)</td>
<td>1)CARE AA+ / CARE A1+ (26-May-16)</td>
<td>1)CARE AA+ / CARE A1+ (11-Dec-15)</td>
</tr>
<tr>
<td>4.</td>
<td>Fund-based - LT-Term Loan</td>
<td>LT</td>
<td>212.10</td>
<td>CARE AA; Stable</td>
<td>-</td>
<td>1)CARE AA+; Stable (06-Feb-18)</td>
<td>1)CARE AA+; Stable (31-Dec-16)</td>
<td>1)CARE AA+; Stable (26-May-16)</td>
<td>1)CARE AA+; Stable (11-Dec-15)</td>
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CIN - L67190MH1993PLC071691