

## Valsad District Co-operative Milk Producers' Union Limited

September 17, 2021

### Ratings

Facilities	Amount (Rs. crore)	Ratings <sup>1</sup>	Rating Action
Long-term Bank Facilities	585.00	CARE AA; Stable [Double A; Outlook: Stable]	Assigned
<b>Total Facilities</b>	<b>585.00</b> (Rs. Five Hundred Eighty Five crore only)		

*Details of facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Valsad District Cooperative Milk Producers' Union Limited (Vasudhara, the union) derive strength from its established operations as one of the oldest unions of Gujarat Co-operative Milk Marketing Federation Ltd. (GCMMF; rated CARE A1+), which has a leading market position in the organized segment of the Indian dairy industry with well-recognized brands 'Amul' and 'Sagar'; along with stable growth prospects for the dairy industry. The ratings further derive strength from its sizeable milk procurement network within and outside Gujarat, growing share of value-added products, presence of a cash flow mechanism towards payment of milk procurement prices which ensures adequate cushion for debt servicing and its strong liquidity; and the same mechanism is expected to continue going forward.

The long-term rating is, however, constrained by the environment and epidemic-related event risks associated with geographically concentrated milk procurement, exposure to risks associated with regulatory changes and volatile skimmed milk powder (SMP) prices as well as union's debt-funded capex plans with associated implementation and stabilization risks.

### Rating Sensitivities

#### Positive Factors (Factors that could lead to positive rating action / upgrade)

- Significant growth in scale of operations through greater geographical diversification of both its sales and sourcing; along with widening of its product profile

#### Negative Factors (Factors that could lead to negative rating action / downgrade)

- Any adverse changes in the Amul cooperative structure and/ or weakening in the credit profile of GCMMF
- Any environment and epidemic-related factors in the milk procuring region of the union having a significant impact on the union's operations for a long term
- Any adverse changes in SMP prices or regulations governing dairy industry having material impact on the extent of returns/ milk procurement prices paid to the farmer members on sustained basis
- Deterioration in overall gearing beyond 4 times, on a sustained basis

### Detailed description of the key rating drivers

#### Key Rating Strengths

**Member of the strong apex dairy marketing federation, GCMMF, which has a significant market share in the organized dairy industry in India:** Vasudhara is one of the oldest member Dairy Processing Units (DPUs) amongst the 18-member DPUs of GCMMF; and it contributed 5% to GCMMF's total sales during FY21 (refers to the period April 1 to March 31). Further, Vasudhara has exclusive rights for selling and distribution of its products in its milk shed area (as per the instructions of GCMMF) and such sales comprised around 40% of its total sales while balance 60% of its sales are made through GCMMF.

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 36 lakh farmers spread across more than 18,565 villages and the daily milk collection of all member DPUs aggregates around 246 lakh litres per day (LLPD) for FY21. Furthermore, with a collective milk processing capacity of 360 LLPD, GCMMF commands a prominent market share in pouched milk and in various milk products (ranging from 38%-72% market share) in the Indian dairy industry.

**Strong pricing power over dairy products due to GCMMF's leading market position coupled with presence of a mechanism for payment of milk procurement prices which ensures adequate debt servicing coverage:** GCMMF, having a prominent market share in the Indian organized dairy industry across various dairy products thus possesses strong pricing power for its products and largely heralds the prices of milk and milk products in the country. Furthermore, GCMMF and

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and in other CARE publications.

its DPUs operate on a two-step pricing mechanism which results in robust cash flows whereby the aim is to pass on remunerative returns to farmer members by way of milk procurement prices but only after ensuring adequate cushion for meeting its upcoming debt servicing, capital and operational expenses. The said mechanism is expected to sustain going forward as well considering the inherent strengths of this business model.

**Sizeable milk procurement network and growing share of value-added products:** Vasudhara has a sizeable milk procurement network of 1,130-member Village Co-operative Societies (VCS) consisting of around 1.22 lakh farmers which ensures smooth and steady supply of milk to the union. It has exclusive milk collection rights in districts of Navsari, Valsad and Dang and has grown its milk procurement to 8.22 LLPD in FY21. Milk procurement, after witnessing moderation of about 10% on y-o-y basis during FY20 increased by 4% in FY21. Also, milk procurement is expected to remain on the higher side in FY22. Furthermore, Vasudhara provides remunerative price to its farmers which stood at Rs.739/kg fat (Rs.735/kg fat in FY20) in FY21 which is envisaged to help it in sustaining its healthy milk procurement going forward. The scale of operations witnessed marginal decline in FY21 owing to its ice-cream sales being lower by more than 50% on y-o-y basis and loss of revenue earned under 'Doodh Sanjeevani Yojana' of Government of Gujarat wherein the government provides milk with their mid-day meal to the primary school children in the tribal talukas of Gujarat owing to closure of schools. However, with rise in milk procurement over the years, the scale of operations of the union has grown at a compounded annual growth rate (CAGR) of 7.09% over past seven years ended FY21 to Rs.1,793.52 crore. Over the years it has added various value-added products in order to diversify its product portfolio, sales of the same has shown an increasing trend that of especially Ghee and Lassi. The ratio of milk: value added products in its sales stood at 76:24 during FY21.

**Stable growth prospects for the dairy industry; albeit exposure to inherent regulatory changes and volatile SMP prices remain:** During FY21, revenues of the organized dairy sector was affected to an extent owing to the impact of Covid-19 pandemic on the institutional demand. With surge of second wave, bulk demand for milk and other dairy products from hotels, restaurants and cafes, sweet marts and tea stalls witnessed contraction. This led to diversion of milk from dairy farmers who were supplying milk to private dairies and unorganized players to the organized dairy co-operatives which resulted in increased quantity of milk sourced. The fall in institutional demand was offset to some extent by the increased consumption by households while the excess milk sourced was converted into SMP and butter resulting in surplus stock of the same. In order to help the dairy sector to liquidate inventory of SMP, there were two major measures announced by the government. Firstly, the Ministry of Fisheries, Animal Husbandry and Dairying, Government of India had introduced a new scheme 'Interest subvention on Working Capital Loans for Dairy sector'. The scheme made provisions for giving interest subvention of 2% per annum, with an additional incentive of 2% per annum to be given in case of prompt and timely repayment/interest servicing on working capital blocked in SMP, Whole Milk Powder (WMP), white butter and ghee for FY21. Secondly, the State Government of Gujarat through the National Dairy Development Board (NDDB), announced subsidy with ceiling of Rs.50/kg of SMP with a maximum budget allocation of Rs.150 crore for the entire scheme which shall be valid for a period of six months from July 01, 2021 to December 31, 2021. SMP prices have witnessed an improving trend in current year which should help the sector to liquidate the higher inventory of SMP. In the medium term, demand for dairy and its allied products is expected to witness healthy demand with lower restrictions as compared to earlier Covid wave, onset of festive season from August 2021, increased home consumption and continuing food-delivery services even in regions witnessing lockdowns. Over the long-term, demand outlook is expected to remain favourable due to various factors such as steady supply of milk with India being world's largest milk producer and government extending various interest subvention schemes / incentives for modernization of dairy infrastructure to promote its higher production; along with growing demand for milk and milk products backed by increasing population and per capita consumption, increase in expenditure on packaged food, brand awareness and urbanization. The growth would be primarily driven by increase in the demand for value-added milk products, which is also margin accretive for the players.

However, the industry remains exposed to inherent risks associated with changes in regulatory environment such as change in government incentives / ban on export of dairy products (mainly SMP), and demand for signing of free trade agreements (FTAs) by surplus milk producing countries such as Australia and New Zealand to gain access to the Indian dairy market which if allowed would increase competition in the sector. Also, unions remain exposed to volatility in SMP prices, which are largely determined by domestic and international demand-supply dynamics along with export competitiveness of Indian players.

#### **Liquidity: Strong**

Vasudhara's liquidity remains strong with the union deriving comfort from sales made on 'cash and carry' basis with daily receipts from GCMMF, while provisional payment to VCS is made on every 10-days' interval, resulting in a comfortable operating cycle (18 days in FY21). Moreover, union also has the flexibility to change the prices paid to the farmers as the funds available with a DPU is passed on to the VCS by way of raw material prices only after retaining a reasonable amount for its debt repayments, capital expenditure and operational expenses during the year. Union had free cash available of Rs.99 crore as on March 31, 2021. Average utilization of Vasudhara's fund based working capital limits remained high at

around 97% over the past 12 months ended July 2021 as it makes payments to the VCS for price difference throughout the year on a regular basis.

### **Key Rating Weaknesses**

**Large debt-funded expansion and up-gradation of milk processing facilities planned over medium-term:** Vasudhara has capex plans of around Rs.210 crore over next three years ending FY24 towards setting up new dairy processing plant at Dhule and Nagpur, expansion and upgradation of existing plant and machinery and setting up of chilling centers. The envisaged capex is expected to be funded by term debt of Rs.140 crore and balance through internal accruals.

Owing to the co-operative structure which aims to pass-on maximum returns to the farmers, the union has modest net worth base and overall gearing level also remain moderate as it requires to undertake capex for modernization and upgradation of milk processing capacities at periodic intervals. Despite factoring planned capex, the overall gearing of the union is expected to improve going forward with accretion of profits to reserves and scheduled repayments of its existing term debt which shall be largely in tandem with additional loans planned to be availed, thus limiting increase in its total debt.

Gradual phasing and stabilization of this capex to optimize payment of milk prices to farmers and maintenance of comfortable liquidity in the union shall be crucial from the credit perspective.

**Exposure to environmental and epidemic-related event risks associated with geographically concentrated milk procurement:** DPUs, including Vasudhara, are exposed to environmental risks (such as outbreak of epidemic/ bovine diseases) associated with concentration in milk collection; since most of their milk procurement is from one district and its surrounding villages. Vasudhara has also built up its milk procurement network outside Gujarat with VCS in Maharashtra in areas of Dhule, Nagpur, Umardhed, Karanjwan and contribution of same to its total milk procurement stood at 16% during FY21. Milk collection from other states is to cater to the requirement of the union's own plant at Boisar, Nagpur, Karnjvan, Navi Mumbai and Umardhed. Further, union is also setting up a new milk processing plant at Dhule which shall increase milk procurement from outside Gujarat.

However, as majority of its total milk procurement in FY21 continued to be from its own milk shed area in Gujarat (i.e., around 84%) the union remains exposed to risks associated with concentrated milk collection.

### **Analytical approach:** Standalone 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 dairy farmers are passed on by way of milk procurement prices after ensuring retention of a reasonable amount for their debt repayment, capital and operational expenses. Furthermore, the Amul dairy cooperative structure has a robust cash flow mechanism, wherein the Marketing Federation (GCMF) releases funds to its DPUs through a two-step price payment mechanism during the year, and DPUs make payments to VCS which in-turn distribute payment to member farmers for their milk supply. Hence, the credit risk of such cooperative sector entities is assessed based on sustainability and growth of the structure, stability of the milk supply base, trend in milk procurement and that of the average annual milk procurement prices paid to the dairy farmers, along with reach of its distribution network and the strong brand of 'Amul' created by the federation.

### **Applicable Criteria**

[Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Liquidity Analysis of Non-financial sector](#)

[Rating Methodology: Notching by factoring linkages in Ratings](#)

[Rating Methodology-Manufacturing Companies](#)

[Financial ratios-Non- Financial Sector](#)

### **About the Company**

Incorporated in 1973, Vasudhara is a cooperative DPU established under the three-tier dairy cooperative structure of Gujarat, known as 'Anand Pattern' or 'Amul Structure'. The union procures milk from around 1,130-member VCS consisting of around 1.22 lakh farmers who hold the entire shareholding in Vasudhara. It had total milk processing capacity of 12.50 lakh litres per day (LLPD) as on March 31, 2021 comprising 7 LLPD from its milk processing units in Gujarat (at Motapondha and Alipur) and 5.50 LLPD from its milk processing units in Maharashtra (at Nagpur and Boisar). Apart from milk processing capacities, it also has capacities for manufacturing of value-added products like ice-cream, curd, flavoured milk, ghee, lassi and buttermilk. Hence, total installed capacity of the union stood at 15.90 LLPD as on March 31, 2021. It also has a cattle feed plant at Khergam, Gujarat with an installed capacity of 300 tonnes per day.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)
Total operating income	1,855.15	1,793.52
PBILDT	100.72	119.41
PAT	12.56	16.93
Overall gearing (times)	1.52	1.29
Interest coverage (times)	2.34	2.18

A: Audited;

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating History (Last three years):** Please refer **Annexure-2**

**Covenants of rated instrument / facility:** Not Applicable

**Complexity level of various instruments rated for this company:** Annexure-3

**Annexure-1: Details of Facilities**

Name of the Instrument/ Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	December 31, 2031	345.00	CARE AA; Stable
Fund-based - LT-Cash Credit	-	-	-	240.00	CARE AA; Stable

**Annexure-2: Rating History (Last three years)**

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based - LT-Term Loan	LT	345.00	CARE AA; Stable	-	-	-	-
2.	Fund-based - LT-Cash Credit	LT	240.00	CARE AA; Stable	-	-	-	-

**Annexure-3: Complexity level of various instruments rated for this company**

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Fund-based - LT-Term Loan	Simple

**Note on complexity levels of the rated instrument:** CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.

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