

## Ajmer Zila Dugdh Utpadak Sahkari Sangh Limited

October 25, 2021

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	15.00	CARE BB+; Stable (Double B Plus; Outlook: Stable)	Reaffirmed
<b>Total Bank Facilities</b>	<b>15.00</b> <b>(Rs. Fifteen Crore Only)</b>		

*Details of instruments/facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of Ajmer Zila Dugdh Utpadak Sahkari Sangh Limited (AZSL; the union) is constrained on account of its highly leveraged capital structure and weak debt coverage indicators, stabilization risk associated with recently concluded large sized debt funded capex, stretched liquidity, environment and epidemic-related risks associated with geographically concentrated milk procurement and competition from the organized and unorganized sector.

The rating, however, derives strength from the established operations of AZSL, strong ownership pattern of the union under three-tier cooperative structure, wide product portfolio under the renowned brand name 'SARAS', established distribution network and stable growth prospects for the dairy industry.

### Rating Sensitivities

*Positive Factors - Factors that could lead to positive rating action/upgrade:*

- Significant increase in scale of operations to more than Rs.900 crore along with widening of product portfolio
- Improvement in capital structure with overall gearing below 2.50x on sustained basis
- Sustained improvement in debt coverage indicators

*Negative Factors- Factors that could lead to negative rating action/downgrade:*

- Any adverse changes in the cooperative structure
- Deterioration in capital structure with overall gearing above 7x on sustained basis
- 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

### Detailed description of the key rating drivers

#### Key Rating Weaknesses

**Recently completed large sized debt funded capex:** During FY17, AZSL undertook a project for installing plant and machinery at its new unit for increasing its milk handling capacity by 8 lakh litres per day (LLPD) and skimmed milk powder capacity by 30 metric tons per day (MTPD) as well as for setting up facilities for manufacturing value added milk products, packing of milk and warehouse. This plant was commissioned in September 2020. Over the past 5 years, AZSL incurred Rs.312 crore towards the project which was funded through term loan of Rs.164 crore, subsidy/grant of Rs.44 crore, equity infusion of Rs.25 crore, unsecured loans from DCS of Rs.27 crore and balance from a mix of internal accruals, fixed deposits, and release of funds from working capital. Going forward, ability of the union to scale up its operations on the back of this large-sized capex will be crucial for its prospects.

**Highly leveraged capital structure and weak debt coverage indicators:** AZSL concluded its expansion capex in FY21. For this, AZSL had availed term loan of Rs.164 crore along with unsecured loans from district cooperative societies (DCS). This coupled with increase in working capital loan led to higher outstanding debt over the past two years. Furthermore, despite equity infusion of Rs.4.78 crore in FY21, net loss resulted in erosion in net worth leading to overall gearing of 5.43x as on FY21 end. Debt coverage indicators also continued to remain weak in FY21 on the back of higher interest cost as well as debt with PBILDT interest coverage of 1.91x and total debt/ GCA of 23.24x.

**Environment and epidemic related risk associated with geographically concentrated milk collection:** AZSL collects milk entirely from its milk procurement centre, spread across Ajmer district in Rajasthan. AZSL's milk procurement channel has grown over last decade; nevertheless, geographical concentration in milk procurement exposes it to environmental risks such as epidemic and could adversely affect its milk supply. Geographical diversification in milk procurement network shall be crucial from credit perspective.

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

**Competition from the organized and un-organized sector:** AZSL faces competition in the dairy segment from other established brands in the organized market as well as from local unorganized players leading to pricing pressure. Foray of dairy companies in the manufacturing of value-added milk products on account of increasing demand in the domestic market is also expected to increase competition for dairy unions like AZSL.

#### Key Rating Strengths

**Longstanding and established track-record of operations:** AZSL has a longstanding track record of operations of more than four decades having commenced its operations in February 1972. Mr Umesh Chandra Vyas (Managing Director of AZSL) has an experience of around three decades in the dairy business. He is supported by well qualified and experienced management team.

**Strong ownership pattern of the union under three tier cooperative structure:** AZSL is jointly owned by DCS (farmer members who hold 99.59%) and Government of Rajasthan (0.41% stake). AZSL operates under a three-tier structure wherein farmers (milk suppliers) own DCS which owns milk producer unions like AZSL. The unions collectively own the Rajasthan Co-operative Dairy Federation (RCDF). It is a vertically integrated structure that establishes a direct linkage between those who produce the milk and those who consume it.

RCDF provides service and support to unions, marketing within & outside the state, liaison with government and NGO agencies; mobilization of resources, product pricing, standardization, coordinating & planning programmes/projects. AZSL develops village/dairy milk cooperative network, procures milk from DCS, processes & sells it. Majority ownership with farmers (milk producers) instils trust in the cooperative model, which ensures quality products to the consumers and remunerative milk procurement prices to the farmer members, while ownership with state results in financial support to the union in the form of interest-free unsecured loans and grants from the state governments.

**Strong brand name along with established distribution network:** RCDF through its unions, provides a complete range of milk and milk products such as ghee, butter, buttermilk, curd, and paneer under the brand name of 'Saras' to parlours/outlets, booths and shop agencies in Rajasthan.

AZSL procures milk from DCS, processes it and sell it under the brand name of 'SARAS'. The union sells its products to the consumers through a well-spread distribution network. The district is divided in 36 milk routes and each route has a separate distribution network including distributors and retailers with products being delivered via milk booths, parlours and agencies.

**Stable scale of operations with wide product portfolio:** AZSL has a wide product portfolio comprising products such as packaged liquid milk, ghee, milk powder, butter, paneer, buttermilk, and curd. Package liquid milk contributed ~60% of AZSL's sales in FY21, providing stability to its operations.

During FY21, AZSL's total operating income moderated by ~12% to Rs.605 crore mainly on account of lower institutional sales during the year due to impact of Covid-19 pandemic. Owing to the cooperative structure of the union, profit margins remain inherently thin with profits being passed on to the farmers by way of milk prices. The union has the flexibility in terms of passing on milk prices to the farmer members depending on its fund requirement for operational and debt servicing purpose. During FY21, AZSL's operating profit (PBILDT) margin increased to 3.96% from 0.94% in FY20 due to relatively lower price paid to farmers owing to requirement of funds for operations. However, interest cost and depreciation were higher due to commencement of new plant which led to net loss of Rs.22 crore in FY21. Despite net loss, AZSL reported cash profit of Rs.12 crore (Rs.3 crore in FY20).

**Stable growth prospects for the dairy industry; albeit exposure to inherent regulatory changes and volatile SMP prices remain:** During FY21, revenue of the organized dairy sector was affected owing to impact of Covid-19 pandemic on the institutional demand. With second wave of pandemic, bulk demand for milk and other dairy products from hotels, restaurants and cafes, sweet marts and tea stalls witnessed contraction. On the other hand, supply was higher due to diversion of milk from private dairies and unorganized players to the organized dairy co-operatives. The excess milk sourced was converted into SMP and butter resulting in surplus stock of the same. To help the dairy sector liquidate inventory of SMP, a new interest subvention scheme was introduced by the Government of India.

In the medium term, demand for dairy and its allied products is expected to witness healthy demand with lower restrictions, 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 for milk and milk products backed by increasing population and per capita consumption, increase in expenditure on packaged food, brand awareness and urbanization.

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: Stretched**

The union had stretched liquidity with high utilization of working capital limits and nominal cash balance of Rs.4 crore as on March 31, 2021. However, operating cycle remained comfortable at 16 days in FY21 with comfort derived from 'cash and carry' sales and some credit period received for payment to be made to DCS.

As per interaction with one of the lenders, utilization of union's working capital borrowings remained ~80% for the past 12 months ended September 2021. Also, the union avails working capital demand loan on periodic basis as per its requirement which it gets at a competitive rate.

#### **Analytical approach: Standalone**

AZSL is a cooperative dairy union which aims at providing remunerative returns to its farmer members who are also its majority shareholders. This keeps its profitability moderate. Furthermore, RCDF also assists its member unions in production, sales, and capital expenditure planning, along with facilitating cash flows between them and Government of Rajasthan. Hence, ratings of such cooperative sector entities are derived based on the sustainability and growth of the structure, stability of the milk supply base, trend in milk procurement, distribution network & brand created by the federation and average annual milk procurement prices paid to farmers.

#### **Applicable Criteria**

[Policy on default recognition](#)

[Financial Ratios – Non financial Sector](#)

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

[Rating Outlook and Credit Watch](#)

[Manufacturing Companies](#)

#### **About the Union**

AZSL was established in February 1972 under Rajasthan Co-Operative Act, 1965 with an aim to pay remunerative milk price along with other services such as animal health care, bovine vaccination, breed improvement and infertility camps to its milk producers (farmer members) and provide quality products to consumer at competitive price. In the union, 99.59% shareholding is held by farmer members while balance 0.41% is held by Government of Rajasthan.

In September 2020, AZSL expanded its milk processing capacity to 10 lakh litres per day (LLPD) and skimmed milk powder capacity to 40 metric tons per day (MTPD). Its key products include ghee, milk, paneer, curd and buttermilk. These are sold under the brand name of 'SARAS'.

The union is an ISO 9001:2008 & IS 15000 (HACCP) certified organization and is affiliated to Rajasthan Co-operative Dairy Federation Limited, Jaipur (RCDF).

<b>Brief Financials (Rs. crore)</b>	<b>31-03-2020 (A)</b>	<b>31-03-2021 (Prov.)</b>
Total operating income	683.95	604.69
PBILDT	6.40	23.97
PAT	2.25	-22.05
Overall gearing (times)	2.91	5.43
Interest coverage (times)	2.53	1.91

A: Audited; Prov: Provisional

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

**Any other information:** Not Applicable

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

**Covenants of rated instrument / facility:** Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

**Complexity level of various instruments rated for this company:** Please refer Annexure-4

**Annexure-1: Details of Instruments / Facilities**

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	15.00	CARE BB+; Stable

**Annexure-2: Rating History of 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-Cash Credit	LT	15.00	CARE BB+; Stable	-	1)CARE BB+; Stable (20-Oct-20)	-	-

**Annexure-3: Detailed explanation of covenants of the rated instrument / facilities – Not Applicable****Annexure-4: Complexity level of various instruments rated for this company**

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Cash Credit	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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