Ratings

CRISIL
An S&P Global Company

Pursuant to SEBI notifications, CRISIL Limited (CRISIL) has transferred its Ratings business to its wholly owned subsidiary, CRISIL Ratings Limited (CRISIL Ratings), with effect from December 31st 2020. Any reference to CRISIL in the documents published by the Ratings division of CRISIL, such as Rating Rationales, Credit Rating Reports, Press Releases, Criteria, Methodology, FAQs, Policies and Disclosures, shall henceforth refer to CRISIL Ratings.

Rating Rationale

January 15, 2021 | Mumbai

Meghmani Finechem Limited

Rating remains on watch 'Watch Developing'

Rating Action

Total Bank Loan Facilities Rated	**Rs.650 Crore**
Long Term Rating	**CRISIL A+/Watch Developing (Continues on watch 'Watch Developing')**

1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL ratings on the bank facilities of Meghmani Finechem Limited (MFL) continues to be on '**Rating Watch with Developing Implications**' (RWDI)'.

CRISIL had placed its ratings on the bank facilities MFL 'Watch with Developing Implications' on February 07, 2020, following the announcement on January 29, 2020, made by MFL's parent, Meghmani Organics Limited (MOL; rated 'CRISIL AA-/Stable/CRISIL A1+') that it has taken board approval for a scheme of arrangement which involves the transfer of the agrochem and pigments businesses [along with the optionally convertible redeemable preference shares (OCRPS) issued to MFL] in MOL into a fully owned subsidiary, Meghmani Organochem Limited (MOCL); followed by amalgamation merger of other business of MOL (Trading and Equity investment in MFL) with its 57% subsidiary, MFL. The existing shareholders of MOL will be issued equity shares in both MOCL and MFL. Eventually MOCL will be renamed as Meghmani Organics Limited.

Through this, the company aims to unlock shareholder value by demerging MOL (housing agrochem and pigments businesses) and MFL (housing the base chemicals and its derivatives business) into two separate listed entities. The company is now awaiting approval from the concerned authorities for the proposed demerger.

CRISIL currently factors need-based financial support from the parent in case of exigencies in its analytical approach; this will be restricted post demerger given that MFL will no longer be a subsidiary of MOL. Given the healthy cash generation and capital structure of MFL, there has been no major requirement for financial support in the past for operations. However, CRISIL notes that the critical operational synergies, common branding, and common promoters between the two entities will remain post demerger also.

CRISIL is closely monitoring the outcome of MFL's demerger from MOL, and will remain in dialogue with the management of MOL and MFL. The rating will be removed from watch and a final rating action taken once necessary regulatory approvals are in place.

MFL's performance was subdued in the first quarter of fiscal 2021 owing to COVID-19 related disruptions in operations and impact on volumes. The company's plants were temporarily shut down in March – April 2020, due to COVID-19 restrictions. However, operations have gradually resumed since May, post receipt of necessary approvals from concerned authorities. Besides, MFL's end-user industries include essential services such as pharmaceuticals, agrochemicals, soaps and detergents, etc. CRISIL expects the volumes to scale up further over the near to medium term. Margins are also expected to sustain at around 25-30%.

MFL's business risk profile should benefit over the medium to long term from increased capacities, improving product mix with addition of chloromethane sulphonate (CMS) and hydrogen peroxide, and healthy operating efficiency. The CMS capacity which was commissioned in July 2019 has already ramped up to 80% utilization. Additional caustic soda capacity and Hydrogen peroxide plants were also commissioned in June, 2020 and July, 2020 respectively. The commissioning of the hydrogen peroxide plant was temporarily delayed due to lockdown related disruptions.

With the commissioning of the above projects, project implementation risk has reduced considerably. Presently, the company is spending towards the epichlorohydrin (ECH) project which is expected to commence operations by fiscal 2022, by which time the CMS, Hydrogen peroxide and caustic soda capacities would have fully stabilised. MFL has also announced fresh capex towards setting up a 30000 TPA project for Chlorinated Polyvinyl Chloride and also for enhancement in capacity of existing caustic soda capacity to 4,00,000 TPA, work for which is yet to start. Timely commissioning, commercialization and ramp up of these capacities will be a key monitorable.

While this capex is expected to be part-debt funded, given healthy cash generation and progressive debt repayments, capital structure is expected to correct from fiscal 2022 onwards as capex benefits accrue into business. Hence, gearing is expected to remain healthy at less than 1.1 time expected over the medium term. Significant delays in stabilization or steep decline in demand can impact ability to generate cash flows and will remain a key rating sensitivity factor.

The rating continues to reflect MFL's business risk profile supported by steady revenue growth, healthy operating margin, and favourable demand prospects. The rating also factors its adequate financial risk profile, supported because of healthy debt protection metrics and moderate capital structure. The ratings also factor support from parent, MOL. These strengths are partially offset by moderate scale of operations in the intensely competitive chlor alkali industry, exposure to regulatory risks, moderate vulnerability of operating margin to fluctuations in caustic soda prices.

Analytical Approach

For arriving at the ratings, CRISIL has factored in operational, and need-based financial support to MFL, from its parent, MOL. However, CRISIL notes that post the demerger, financial fungibility between MOL and MFL will be limited.

Key Rating Drivers & Detailed Description

Strengths

Steady revenue growth, healthy operating margin and demand prospects: Revenue visibility over the medium term will be driven by steady demand for caustic soda and ramping of new capacities, such as CMS and hydrogen peroxide, and increased capacity for caustic soda, even as electrochemical unit (ECU) realizations have greatly moderated from the highs seen in fiscal 2019. The company has maintained a comfortable operating margin of over 30% (despite certain volatility), owing to its low-cost production model. It supplies 6-7% of its production to MOL, and 4-5% of output to other group companies. The rest is sold to external clients, with whom the company has maintained strong relationships.

Adequate financial risk profile: Large on-going part debt-funded capex has resulted in gearing increasing to 0.9 time as of March 31, 2020 from 0.14 times as of March 31, 2018. However capital structure remains adequate. Capex spend is expected to gradually reduce in fiscals 2021 and 2022. As the benefits of new projects and capacities accrue into business, capital structure and debt protection metrics should improve over the medium term. Net cash accrual to total debt is at about 0.3 times and interest cover at 7 times for fiscal 2020.

Weaknesses

Moderate, though improving, scale of operations in the intensely competitive chlor alkali industry: The chlor alkali industry is intensely competitive and dominated by large players such as Gujarat Alkalis and Chemicals Ltd, DCM Shriram Ltd, Grasim Industries Ltd, and Reliance Industries Ltd (rated 'CRISIL AAA/Stable/CRISIL A1+'). The top 7 players together hold 40-50% of the market share. While MFL has been growing at a healthy pace and new products will add to revenue visibility further, scale of operations will remain moderate compared to peers.

Vulnerability to fluctuations in caustic soda prices and regulatory risk: Profitability of caustic manufacturing companies depends on the prevailing ECU prices. Cyclical downturns or adverse variability in demand-supply balance, may drag down realisations for caustic soda players. In August 2015, the government of India imposed an anti-dumping duty of $48.39 per tonne and $21.90 per tonne on caustic soda imports from South Korea and China, respectively. Hence, prices could come under pressure in the event of increased imports from China, and removal of anti-dumping duty, thus impacting profitability of domestic players including MFL. This is reflected in the company's operating margin, which has ranged from 30-45% in the past six years.

Liquidity- Strong

MFL's liquidity is strong. It is supported by expected cash generation, at over Rs 100 crore in fiscal 2021 and over Rs 140 crore in fiscal 2022. Against this, the company has long term debt obligations of about Rs 88 crore and Rs 130 crore per annum in fiscals 2021 and 2022. Cash accruals may be tightly matched with debt obligations and incremental working capital requirements in fiscal 2021 due to COVID-19 impact on operations and demand. However, CRISIL draws comfort from the headroom available in its fund based working capital limits which have been utilised at less than 20% on average over the past twelve months ended July 2020. The company is expected to rely on the same in case of any cash flow mismatches. Besides, refinancing is also not expected to be a challenge considering the strong vintage and franchise with lenders being a part of 'Meghmani' group.

Rating Sensitivity factors

Progress on the demerger of MFL from MOL will remain a key monitorable over the medium term. The rating will be removed from watch and a final rating action taken once necessary regulatory approvals are in place

Upward factors:

- Improvement in operating performance driven by swift ramp up of new capacities – sustained revenue growth of more than 12-14% and operating margins of over 30%
- Sustenance of healthy financial risk profile - debt/EBITDA remaining at less than 2.5 times, post commissioning of new capacities.

Downward factors:

- Significant moderation in performance – operating margins deteriorating to less than 18-20% on a sustained basis
- Significant delay in ramp up of new capacities or higher than expected debt availed for funding the capex leading to deterioration in credit metrics - debt/EBITDA of over 3 times on a sustained basis.

About the Company

MFL, part of the Ahmedabad-based Meghmani group, was incorporated in September 2007 as a subsidiary of Meghmani Organics Ltd (MOL), to establish a captive source of caustic soda and chlorine derivatives. Currently, MOL holds 57.16% stake in MFL, while the Meghmani group's promoters hold the balance 42.84%.

MFL started operations from July 2009 with an installed capacity for manufacturing 119,000 tonne per annum (tpa) of caustic soda; the capacity was enhanced to 187,600 tpa (caustic soda 166,600 tpa and caustic potash 21,000 tpa) as of March 31, 2016, and a 60-megawatt captive power plant was added at Dahej, Gujarat.

Key Financial Indicators

Particulars	Unit	2020	2019
Revenue	Rs crore	611	710
Profit after Tax	Rs crore	114	183
PAT Margin	%	18.7	25.7
Adjusted Debt/Adjusted networth	Times	0.9	0.8
Interest Coverage	Times	7.1	12.6

For the first 6 months of fiscal 2021, MFL had revenues of about Rs 349 crore and EBITDA of Rs 113 crore as compared to revenues of Rs 334 crore and EBITDA of Rs 126 crore in the corresponding period of the previous fiscal.

Any other information: Not applicable

Note on complexity levels of the rated instrument:
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Annexure - Details of Instrument(s)

ISIN	Name of Instrument	Date of Allotment	Coupon Rate (%)	Maturity Date	Issue Size (Rs crore)	Complexity levels	Rating Assigned with Outlook
NA	Working Capital Facility	NA	NA	NA	133.5	NA	CRISIL A+/Watch Developing
NA	Long Term Loan	NA	NA	July 2024	372.5	NA	CRISIL A+/Watch Developing
NA	External Commercial Borrowings	NA	NA	NA	144	NA	CRISIL A+/Watch Developing

Annexure - Rating History for last 3 Years

	Current			2021 (History)		2020		2019		2018		Start of 2018
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating

Fund Based Facilities	LT	650.0	CRISIL A+/Watch Developing		--	21-10-20	CRISIL A+/Watch Developing	30-09-19	CRISIL A+/Positive	21-09-18	CRISIL A+/Stable	CRISIL A/Stable
			--		--	06-05-20	CRISIL A+/Watch Developing	01-07-19	CRISIL A+/Positive	17-05-18	CRISIL A+/Stable	--
			--		--	07-02-20	CRISIL A+/Watch Developing		--	17-04-18	CRISIL A+/Stable	--

All amounts are in Rs.Cr.

Annexure - Details of various bank facilities

Current facilities			Previous facilities		
Facility	**Amount (Rs.Crore)**	**Rating**	**Facility**	**Amount (Rs.Crore)**	**Rating**
External Commercial Borrowings	**144**	**CRISIL A+/Watch Developing**	**External Commercial Borrowings**	**144**	**CRISIL A+/Watch Developing**
Long Term Loan	**372.5**	**CRISIL A+/Watch Developing**	**Long Term Loan**	**372.5**	**CRISIL A+/Watch Developing**
Working Capital Facility	**133.5**	**CRISIL A+/Watch Developing**	**Working Capital Facility**	**133.5**	**CRISIL A+/Watch Developing**
Total	**650**	**-**	**Total**	**650**	**-**

Links to related criteria
CRISILs Approach to Financial Ratios
Rating criteria for manufaturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating Criteria for Chemical Industry
Criteria for Notching up Stand Alone Ratings of Companies based on Parent Support

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CRISIL Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence, analytical rigour and innovation, we set the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 33,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs).

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For more information, visit www.crisil.com/ratings

About CRISIL Limited

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