Ratings
CRISIL Ratings Limited (A subsidiary of CRISIL Limited)

CRISIL
An S&P Global Company

Rating Rationale

December 22, 2021 | Mumbai

Meghmani Finechem Limited

Rated amount enhanced

Rating Action

Total Bank Loan Facilities Rated	**Rs.850 Crore (Enhanced from Rs.720 Crore)**
Long Term Rating	**CRISIL AA-/Stable (Reaffirmed)**

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

Detailed Rationale

CRISIL Ratings has reaffirmed its rating on the long term bank facilities of Meghmani Finechem Limited (MFL) at 'CRISIL AA-/Stable'.

CRISIL Ratings had on December 01, 2021, upgraded its rating on the long term bank facilities of MFL to 'CRISIL AA-/Stable' from 'CRISIL A+/Positive'.

The rating factors sustenance of healthy capacity utilization rates across all product segments and faster than estimated ramp up of newly commissioned Hydrogen Peroxide facility resulting in strong revenue growth during the first half of fiscal 2022 while maintaining operating margins at healthy levels. Company's products being in essential category; its operations were not impacted by the second wave of the pandemic and all segments recorded capacity utilization rates of greater than 80% during the first half of fiscal 2022. The Choloromethane Sulphonate (CMS) capacity which was commissioned in July 2019 operated at ~100% while additional caustic soda capacity and Hydrogen peroxide facility which were commissioned in June, 2020 and July, 2020 respectively also operated at over 80%. Operating margins too remained healthy at over 30% despite continuous increase in prices of key inputs like coal and salt due to healthy realizations on all its products, healthy operating efficiency owing to highly integrated nature of operations and better operating leverage with increase in scale of operations. This improvement is expected to sustain going forward as well and CRISIL Ratings expects MFL to post year on year revenue growth of over 35-40% for the full fiscal while maintaining operating margins at ~27-28%. Also capacity expansions being undertaken in downstream chlorine and hydrogen products like Epichlorohydin (ECH) and Chlorinated Polyvinyl Chloride (CPVC) are progressing as per plan and are expected to be commissioned by the first half of fiscal 2023. The capacity expansion being undertaken is expected to strengthen MFL's business risk profile over the medium term with increased product diversification and higher share of revenues coming from downstream products thereby mitigating the volatility in margins brought about by the purely commoditized nature of caustic soda. Share of caustic soda in total revenues has been steadily coming down from ~85% in fiscal 2019 to under 70% during the first half of fiscal 2022 and is further expected to come down to ~50-55% over the next 2-3 years. Contribution from these downstream chlorine and hydrogen products along with healthy utilization rates in existing facilities are expected to drive healthy revenue growth over the medium term.

Given MFL's strong track record in execution of complex projects like CMS and Hydrogen Peroxide over the last 2 fiscals, implementation risk for the current expansions is presumably low. Presently, the company is implementing an epichlorohydrin (ECH) project which is expected to commence operations by first quarter of fiscal 2023. MFL has also started work on further expansion of caustic soda capacity to ~400,000 tonnes from the existing 294,000 tonnes and captive power plant to 132 MW from 96 MW at an estimated cost of ~Rs 230 crore. Work on the 30,000 ton per annum CPVC plant has also started. Both these projects are in advanced stages and are expected to be commissioned by the first half of fiscal 2023. The total estimated cost for the aforementioned projects is Rs. 700 crore and expected to be funded through debt of Rs. 400-450 crore and balance through internal accruals. Cost incurred on these projects till September'2021 stood at ~ Rs. 365 crore and debt drawn down for these projects stood at Rs. 238 crore.

MFL has also announced a new project for setting up a chloro toluene derivative project for Rs 180 crore to be commissioned by fiscal 2024. Commercialization and ramp up of these capacities and consequent stabilization of operating margins will be a key rating monitorable.

MFL's financial risk profile has been on an improving trend despite capex being undertaken due to strong operating performance of existing as well as newly commissioned facilities resulting in healthy cash accruals thereby enabling the company to fund its projects in a prudent debt equity mix. Due to this ongoing capex, CRISIL Ratings expects MFL's debt level to increase in current fiscal thereby resulting in marginal increase in gearing and key debt metrics like debt to Earnings before Interest, depreciation, tax and amortization (EBIDTA) to ~1 time and 2.2 time from 0.8 time and 2.05 time respectively in fiscal 2021. However, these metrics are expected to improve from fiscal 2023 onwards with progressive debt repayments and accruals being used to meet incremental capex and working capital requirements. Gearing is expected to improve to ~0.7 time by March 31, 2023, while Debt to Earnings before Interest, Depreciation and Tax and Amortisation

(EBITDA) ratio is also expected to come below 1.6 time by end of fiscal 2023. Improvement in debt metrics, will nevertheless, remain sensitive to any cost overruns, which may necessitate additional debt funding.

The rating continues to reflect MFL's improving business risk profile supported by steady revenue growth, healthy operating margin and good demand prospects. The rating also factors its adequate and improving financial risk profile. These strengths are partially offset by the company's high revenue dependence on the intensely competitive chlor alkali industry, exposure to regulatory risks, moderate vulnerability of operating margin to fluctuations in caustic soda prices and also exposure to project implementation risks, though lower than earlier.

Approval from NCLT for demerger of MFL from Meghmani Organics Limited (MOL) ('CRISIL AA-/Stable/CRISIL A1+') was received in May, 2021 post which MFL was separately listed on the stock exchanges with promoters currently holding 72.6% of the shareholding. As a part of the demerger process, Optionally Convertible Redeemable Preference Shares (OCRPS) of Rs. 211 crore issued to MOL have been converted to Redeemable Preference Shares (RPS)

Analytical Approach

For arriving at the ratings, CRISIL Ratings has considered the standalone business and financial risk profile of MFL.

CRISIL Ratings has also treated the RPS of Rs 211 crore issued to MOL as equity on account of high equity like nature of the instrument and understanding that redemption is not expected over the medium term.

Key Rating Drivers & Detailed Description

Strengths

Steady revenue growth, healthy operating margin and good demand prospects: Revenue visibility over the medium term will be driven by steady demand for caustic soda and new products such as hydrogen peroxide and CMS and quick ramp up of upcoming facilities for ECH and CPVC. Even though electrochemical unit (ECU) realizations have greatly moderated from the highs seen in fiscal 2019, company has managed to grow at a healthy CAGR of ~15% over last 5 fiscals. The company has maintained a comfortable operating margin of over 30% (despite certain volatility), owing to its integrated nature of operations and low-cost production model. Most of MFL's chlorine and hydrogen derivative products like CMS, ECH and CPVC are aimed at import substitution as domestic capacities are low and there is a demand supply mismatch in these products. This is expected to continue over the medium term as well aiding MFL's revenue growth and diversification from base chemicals like caustic soda.

Adequate and improving financial risk profile: MFL has availed debt for funding past capex which has resulted in gearing increasing to ~0.8 time as of March 31, 2021 from 0.14 times as of March 31, 2018. Capex spending is expected to continue over the next two fiscals, but reliance on debt will be lower due to strong accruals. The ECH plant is expected to be commissioned in first quarter of fiscal 2023 while CPVC and caustic soda plants are expected to be commissioned by first half of the fiscal 2023. As the benefits of new projects and capacities accrue into business, capital structure and debt protection metrics should improve over the medium term. Besides, ongoing capex is also modular in nature, and can be postponed, in the event of sharp deterioration in demand or any external exigencies.

Weaknesses

High though moderating dependence on 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 remains moderate compared to peers. Besides, currently around 70% of its revenues are derived from the chlor-alkali segment, especially caustic soda, which is commoditized in nature, and prone to business cycles. Nevertheless, with addition of new downstream products, dependence on caustic soda revenues will gradually decline over the medium term.

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. The company's operating margin has ranged from 30-45% in the past six years, reflective of the aforesaid factors.

With MFL diversifying into downstream chlorine derivative products like CMS, ECH and CPVC, contribution from caustic soda is expected to reduce in the future which will help in stabilizing operating profitability and accruals.

Liquidity: Strong

MFL's liquidity is strong. Cash generation is expected to exceed Rs.230 crore in fiscal 2022, and over Rs. 300 crore in fiscal 2023, which will suffice to meet long term debt repayment obligations of about Rs. 122 crore and Rs.139 crore in respective years, besides incremental working capital requirements. CRISIL Ratings also draws comfort from the headroom available in its fund based working capital limits of Rs 180 crore which have been moderately utilized at less than 50% on average over the past 6 months ended September, 2021. The company is expected to rely on the same in case of any cash flow mismatches

Outlook: Stable

CRISIL Ratings believes the MFL's business risk profile will continue to benefit from diversification in product profile with increased proportion of revenues expected to come from chlorine derivatives over the medium term. Further, integrated nature of operations coupled with healthy operating leverage should support operating efficiencies going forward. While debt levels are likely to peak in fiscal 2022, healthy cash accruals and progressive debt repayment, will help buttress impact of debt addition for ongoing projects, enabling improvement in debt metrics over the medium term.

Rating Sensitivity Factors
Upward factors:
- Improvement in operating performance driven by swift ramp up of new capacities, supporting double digit revenue growth and operating margins of ~28-30%
- Continued improvement in financial profile and debt metrics; for instance, debt/EBITDA remaining at less than 1.2-1.4 times

Downward factors:
- Significant moderation in performance – operating margins deteriorating to less than 20-22% on a sustained basis
- Significant delay in commissioning of new capacities or higher than expected debt availed for funding the capex leading to deterioration in credit metrics - debt/EBITDA of over 2.5-2.7 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. Pursuant to NCLT approval for demerger, MFL was listed on the stock exchanges with the promoters currently holding 72.6% of the equity stake with balance being held by public.

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. Subsequently, MFL has also enhanced capacities for caustic soda to 294000 tpa as well as commissioned new facilities for manufacturing of CMS (50000 tpa) and Hydrogen Peroxide (60000 tpa)

For the first 6 months of fiscal 2021, MFL registered revenues of Rs 630 crore and profit after tax of Rs 84 crore as compared to revenues of Rs 349 crore and operating profits of Rs 44 crore in the corresponding period of the previous fiscal.

Key Financial Indicators

Particulars*	Unit	2021	2020
Revenue	Rs.Crore	830	611
Profit After Tax (PAT)	Rs.Crore	101	108
PAT Margin	%	12.1	17.8
Adjusted Debt/Adjusted networth	Times	0.8	0.9
Interest Coverage	Times	9.05	18.3

**CRISIL adjusted*

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	180.00	NA	CRISIL AA-/Stable
NA	Long Term Loan	NA	NA	Sept-2028	417.86	NA	CRISIL AA-/Stable
NA	Long Term Loan	NA	NA	Sept-2027	160.81	NA	CRISIL AA-/Stable
NA	External Commercial Borrowing	NA	NA	NA	86.40	NA	CRISIL AA-/Stable
NA	Proposed Long Term Bank Loan Facility	NA	NA	NA	4.93	NA	CRISIL AA-/Stable

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	850.0	CRISIL AA-/Stable	01-12-21	CRISIL AA-/Stable	21-10-20	CRISIL A+/Watch Developing	30-09-19	CRISIL A+/Positive	21-09-18	CRISIL A+/Stable	CRISIL A/Stable
			--	07-05-21	CRISIL A+/Positive	06-05-20	CRISIL A+/Watch Developing	01-07-19	CRISIL A+/Positive	17-05-18	CRISIL A+/Stable	--
			--	27-04-21	CRISIL	07-02-20	CRISIL		--	17-04-18	CRISIL	--

					A+/Positive		A+/Watch Developing				A+/Stable	
			--	15-01-21	CRISIL A+/Watch Developing		--		--		--	--

All amounts are in Rs.Cr.

Annexure - Details of Bank Lenders & Facilities

Facility	Amount (Rs.Crore)	Name of Lender	Rating
External Commercial Borrowings	86.4	Standard Chartered Bank Limited	CRISIL AA-/Stable
Long Term Loan	130	HDFC Bank Limited	CRISIL AA-/Stable
Long Term Loan	50	HDFC Bank Limited	CRISIL AA-/Stable
Long Term Loan	70	State Bank of India	CRISIL AA-/Stable
Long Term Loan	108.33	HDFC Bank Limited	CRISIL AA-/Stable
Long Term Loan	44	HDFC Bank Limited	CRISIL AA-/Stable
Long Term Loan	85.53	The Federal Bank Limited	CRISIL AA-/Stable
Long Term Loan	90.81	State Bank of India	CRISIL AA-/Stable
Proposed Long Term Bank Loan Facility	4.93	Not Applicable	CRISIL AA-/Stable
Working Capital Facility	40	HDFC Bank Limited	CRISIL AA-/Stable
Working Capital Facility	90	ICICI Bank Limited	CRISIL AA-/Stable
Working Capital Facility	50	Standard Chartered Bank Limited	CRISIL AA-/Stable

This Annexure has been updated on 22-Dec-2021 in line with the lender-wise facility details as on 22-Dec-2021 received from the rated entity.

Criteria Details

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

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