Merino Industries Limited

December 27, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Ratings[1]	Rating Action
Long-term bank facilities	431.17 (Enhanced from 140.95)	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Reaffirmed
Long-term/Short-term (LT/ST) bank facilities	75.00	CARE AA-; Stable / CARE A1+ (Double A Minus; Outlook: Stable/ A One Plus)	Assigned
Long-term/Short-term (LT/ST) bank facilities	66.00 (Enhanced from 36.00)	CARE AA-; Stable / CARE A1+ (Double A Minus; Outlook: Stable/ A One Plus)	Reaffirmed
Short-term bank facilities	205.00 (Reduced from 210.00)	CARE A1+ (A One Plus)	Reaffirmed
Short-term bank facilities	-	-	Withdrawn
Total bank facilities	**777.17 (₹ Seven hundred seventy seven crore and seventeen lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Merino Industries Limited (MIL) continue to draw strength from the long and established track record of the company in the laminates industry with strong brand positioning and pan-India presence with an extensive distribution network. MIL is one of the largest players in the domestic organized laminates business and also has significant presence in the export market. The ratings also derive comfort from its comfortable capital structure, healthy debt coverage indicators and strong liquidity profile.

The ratings take note of the improvement in capacity utilisation of laminates in FY22 (refers to the period April 01 to March 31) and H1FY23 which, along with increase in realisation, has led to significant growth in total operating income (TOI) during the aforesaid period. However, the operating profitability (profit before interest, lease rentals, depreciation and taxation [PBILDT]) margins have reduced in FY22 and H1FY23 due to the significant increase in raw material prices which the company was not able to pass on fully. Going forward, with price hikes taken by the company and stabilization of raw material prices, the margins are expected to improve.

The ratings continue to remain constrained by the susceptibility of its profitability to volatility in raw material prices, exposure to foreign exchange fluctuations, working capital intensive nature of operations and dependence on the prospects of the real estate sector. The ratings are further constrained by its ongoing large-sized greenfield project for particle boards. The ratings also take note of other capacity additions coming up in the industry which may increase the competitive intensity when these capacities come onstream.

Care Ratings Limited has withdrawn the rating assigned to the short-term fund-based/non-fund-based limit from one of the lenders of the company as the same has been surrendered by the company.

Rating Sensitivities

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

- Ability to significantly increase scale of operations with greater product diversification along with improvement in PBILDT margin beyond 18% and return on capital employed (ROCE) beyond 20% on a sustained basis.
- Total debt/PBILDT remaining below unity while maintaining its comfortable overall gearing on sustained basis.
- Sustaining the improvement in its working capital cycle.

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

- Time and cost overrun in the current planned capex resulting in deterioration in overall gearing ratio > 0.50x and Total Debt/PBILDT > 2.50 times on a sustained basis given that the project is presently at a nascent stage.
- Operating profit margin remaining below 12% on a sustained basis.
- Elongation in the operating capital cycle to above 150 days on a sustained basis.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

- Decline in free cash and liquid investments below ₹100 crore on a sustained basis.

Detailed description of the key rating drivers
Key Rating Strengths
Established presence in the laminates industry with moderately diversified revenue profile:
MIL was originally established in 1965 as a trading unit and subsequently commissioned its operations of manufacturing plywood and laminates in early 1970s. Accordingly, the promoter, the Lohia family, has over five decades of experience in the laminates industry. The group is also continuously channelising its marketing strategies to widen its market share in the organised laminates segment.
MIL is one of the largest players in the domestic laminates industry and its products are sold under the established brand name 'Merino Laminates'. While the revenue stream is primarily dominated by the laminates segment, the revenue profile reflects some product diversification. The decorative laminates segment contributed around 74% of its revenue in FY22, and the balance was contributed by its panel products and furniture division (17%), potato flakes division (3%), trading and others (4%). To further diversify its product offerings, the company is setting up a greenfield particle board project which is expected to be commissioned in Q1FY24.

Extensive distribution network with growing export presence:
MIL, by virtue of its established presence through the brand 'Merino' has been able to establish a strong pan-India marketing network with more than 850 distributors and dealers and over 18,000 retail outlets across the country. Furthermore, it has 11 warehouses pan-India. This apart, the company exports to more than 70 countries with agents based out of West Asia, Bangladesh and South-east Asia. The major export destinations are USA, Singapore, United Kingdom, Israel and Mexico. Exports contributed about 31% of its TOI in FY22 (30% in FY21). Furthermore, the group's extensive distribution network is supported by various marketing and branding exercises across its product divisions.
MIL spent around 9% of its net sales towards selling expenses in FY22 as compared with 8% in FY21. Selling expenses increased mainly on account of increase in packaging costs as well as ocean freight. The company is expected to continue to invest in growing its brand through various marketing strategies.

Comfortable capital structure and healthy cash accruals:
The capital structure of the company continues to remain comfortable with healthy cash accruals. Though the overall gearing ratio moderated from 0.19x as on March 31, 2021 to 0.33x as on March 31, 2022, on account of both increase in term debt for the project as well as working capital utilisation, it continued to remain comfortable. Going forward, though the capital structure is expected to moderate on account of debt-funded capex being undertaken in Gujarat, it is expected to remain comfortable.
The increase in debt led to moderation in the debt coverage indicators of the company with Total debt/GCA moderating from 1x as on March 31, 2021 to 1.94x as on March 31, 2022.
Despite decline in profitability, the interest coverage ratio witnessed an improvement from 12.31x in FY21 to 15.55x in FY22 on account of reduction in interest costs. Going forward, its capital structure and debt coverage indicators are expected to moderate; albeit are likely to remain healthy.

Stable demand outlook; albeit large capex plans in the industry may increase competitive intensity: The Indian furniture industry is expected to witness continuous growth on the back of rising per capital income levels, rapid urbanisation and rise of consumer class. Going forward, the demand for furniture products is likely to be primarily driven by growth in demand from the hospitality sector, healthcare sector, commercial office space sector and retail space sector. The demand for decorative laminates has been witnessing growth and finding increasing usage in ready-to-assemble furniture, cabinets, flooring and other solutions across both residential and commercial sectors. However, the demand for interior infrastructure products is directly linked to the prospects of the real estate industry. Hence, any downturn in the real estate business could have an adverse effect on the revenue of the company. Furthermore, MIL remains exposed to significant competition from both the organised and the unorganised sector players for its various product segments apart from the threat of imports.

Liquidity: Strong
MIL has a strong liquidity position with unencumbered cash and cash equivalents of ₹330.34 crore along with unutilised fund-based working capital limits of ₹168 crore as on September 30, 2022. The company has debt repayment obligation of ₹19.86 crore in FY23 out of which the company has already repaid ₹10.55 crore till September 30, 2022 and the balance is expected to be comfortably met out of cash accruals to be generated by the company in H2FY23. The average fund-based working capital limit utilisation of the company stood at around 62% during the last 12 months ended October 2022. With an overall gearing of 0.33x as on March 31, 2022, the company has sufficient gearing headroom to raise additional debt for its capex. The debt required for the project has already been sanctioned. The existing liquidity with the company is likely to be sufficient to meet

the requirement of the equity portion for the project.

Key rating weaknesses

Moderation in profitability margins in FY22 and H1FY23, though significant growth in revenue:

The capacity utilisation (CU) for the laminate division improved from 62.61% in FY21 to 76.74% in FY22 despite the second and third waves of COVID-19 pandemic. The increase in installed capacity has led to the CU being lower than the pre-COVID levels, however, in terms of volumes, the company's production stood higher than the pre-COVID levels. Accordingly, the TOI of MIL witnessed a significant growth of 35% y-o-y in FY22. The increase in revenue is marked by both increase in sales volumes as well as realisation (around 6%) of both laminates and panel products & furniture. The growth in laminates has been witnessed both on the domestic front as well as in the international market in terms of volume as well as sales realisation of decorative laminates.

However, the PBILDT margin moderated from 16.82% in FY21 to 12.50% in FY22 on account of increase in input prices (which could not be passed on completely) along with increase in employee expenses and selling expenses.

In H1FY23, TOI of MIL witnessed a growth of 36% y-o-y backed by increase in volumes on account of growth in demand from real estate sector. PBILDT margin, however, continued to witness contraction from 14.14% in H1FY22 to 10.79% in H1FY23 mainly on account of increase in material cost which could not be completely passed on, increase in power costs as well as selling expenses. Going forward, the profitability margins of MIL are expected to improve with price hikes taken by the company and stabilization of raw material prices.

Inherent project risk associated with its planned large-size particle board project:

MIL is setting up a greenfield engineered wood/particle board plant in Halol, Gujarat, at a capex of about ₹652 crore. The capex is being funded through debt and internal accruals broadly in the ratio of 1:1. The company has received sanction for the debt component of the project and the existing available liquidity along with the internal accruals to be generated are expected to be adequate to meet the equity contribution towards the project. The company has already spent ₹434.41 crore on this project by October 31, 2022.

The company, however, remains exposed to inherent pre and post project implementation risks for the project. The size of the capex is large at around 56% of its net worth as on March 31, 2022. The company has an established marketing and distribution network which it plans to leverage for marketing the new products. Although the demand for particle boards has been witnessing growth and the company has ventured into this product with an aim towards product diversification in its revenue mix as well as to drive growth in its scale, the significant capacity additions announced in the particle board and MDF sector by other industry players may increase the competitive intensity when all these capacities come onstream and thus could impact the envisaged returns on this capex. The plant is expected to commence commercial operation in Q1FY24. Timely implementation of the project within envisaged cost parameters and generation of envisaged returns thereafter from the project would be a key monitorable.

Working capital intensive nature of operations:

The operations of the company are working capital intensive in nature on account of its high inventory holding period due to large number of product variants and requirement of raw material stocking since significant proportion of raw materials are imported with a long lead time. The company provides credit of about 30-45 days and avail credit from its suppliers of about 45-60 days. The operating cycle of the company improved from 127 days in FY21 to 84 days in FY22 mainly on account of reduction in inventory holding period from 144 days in FY21 to 101 days in FY22. This was despite increase in inventory on an absolute basis, mainly on account of significant growth in its scale of operations.

Raw material price fluctuation risk and exposure to foreign exchange fluctuation

Raw material cost formed about 60%-65% of the total cost of sales for MIL during FY20-FY22. The major raw materials for the company are paper and various chemicals. The design paper which imparts the required design to the laminates is primarily imported from Europe. Furthermore, around 30%-40% of the Kraft paper which lends the thickness to the laminates is imported from USA, while the balance is domestically sourced. The other major raw materials, which consists of phenol, melamine, and methanol are primarily (around 70%-80%) imported from China and USA. Methanol and Phenol being the primary chemical requirements, their availability and price has a significant impact on the operating margins of the company. Prices of both the products in international market are highly volatile (as they are a crude oil derivative). Furthermore, any increase in the raw material prices is normally passed on to the customers largely with certain time lag and depending upon competitive landscape. MIL is a net exporter. During FY22, MIL imported raw materials worth ₹418 crore against ₹225 crore in FY21. However, as the company exports around 30% of its gross sales (₹534 crore in FY22 as against ₹380 crore in FY21), it is partially insulated against foreign exchange fluctuation by way of natural hedging. MIL had net unhedged foreign currency exposure of ₹99.86 crore as on March 31, 2022 as against ₹61.25 crore as on March 31, 2021. The company earned forex gain of ₹15.94 crore in FY22 as against ₹7.14 crore in FY21.

Environmental, Social and Governance (ESG) factors

MIL has an established environmental policy as a part of its initiatives towards sustainability including water management, waste management, energy conservation and safety and wellness systems to ensure sustainability of operations. It also meets its social responsibilities and has a healthy governance framework with adequate level of disclosures.
The Board of Directors of MIL comprises of 13 members out of which two are independent directors. MIL spent ₹3.12 crore in FY22 as against its 2% obligation (net of set-off available from previous year) amounting to ₹1.65 crore on various Corporate Social Responsibility (CSR) programs.

Analytical approach: Standalone

Applicable Criteria

Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Policy on Withdrawal of Ratings

About the Company

MIL is the flagship company of the Merino group. With track record of over five decades, MIL is a leading manufacturer and exporter in the laminates industry and occupies a substantial market share of the organised laminates segment. It has four manufacturing facilities with pan-India presence and exports to more than 70 countries. Furthermore, it is also engaged in the manufacturing of potato flakes, pre-laminated boards and furniture units along with providing allied interior solutions and small-time trading of laminates, chemicals, other panel products and potatoes.

Brief Financials (₹crore)	FY21 (A)	FY22 (A)	H1FY23 (UA)
TOI	1304.02	1763.83	1107.16
PBILDT	219.34	220.54	119.41
PAT	131.86	132.22	93.08
Overall gearing (times)	0.19	0.33	0.46
Interest coverage (times)	12.31	15.55	13.79

A: Audited; UA: Unaudited; Financials are reclassified as per CARE Ratings standards

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: Annexure 4

Annexure-1: Details of Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash credit		-	-	-	67.00	CARE AA-; Stable
Fund-based - LT-Term loan		-	-	Jan 2027	347.17	CARE AA-; Stable
Fund-based - LT-Working capital demand loan		-	-	-	17.00	CARE AA-; Stable
Fund-based - LT/ ST-EPC/PSC		-	-	-	66.00	CARE AA-; Stable / CARE A1+
Fund-based - ST-Working Capital Demand loan		-	-	-	75.00	CARE A1+
Fund-based/Non-fund-based-Short term		-	-	-	0.00	Withdrawn
LT/ST Fund-based/Non-fund-based-PSF/CC/LC/BG		-	-	-	75.00	CARE AA-; Stable / CARE A1+
Non-fund-based - ST-Letter of credit		-	-	-	130.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term loan	LT	347.17	CARE AA-; Stable	-	1)CARE AA-; Stable (06-Jan-22)	1)CARE AA-; Stable (08-Jan-21)	1)CARE AA-; Stable (18-Dec-19)
2	Fund-based - LT/ ST-EPC/PSC	LT/ST*	66.00	CARE AA-; Stable / CARE A1+	-	1)CARE AA-; Stable / CARE A1+ (06-Jan-22)	1)CARE AA-; Stable / CARE A1+ (08-Jan-21)	1)CARE AA-; Stable / CARE A1+ (18-Dec-19)
3	Fund-based - LT-Cash credit	LT	67.00	CARE AA-; Stable	-	1)CARE AA-; Stable (06-Jan-22)	1)CARE AA-; Stable (08-Jan-21)	1)CARE AA-; Stable (18-Dec-19)
4	Non-fund-based - ST-Letter of credit	ST	130.00	CARE A1+	-	1)CARE A1+ (06-Jan-22)	1)CARE A1+ (08-Jan-21)	1)CARE A1+ (18-Dec-19)
5	Fund-based - LT-Working capital demand loan	LT	17.00	CARE AA-; Stable	-	1)CARE AA-; Stable (06-Jan-22)	1)CARE AA-; Stable (08-Jan-21)	1)CARE AA-; Stable (18-Dec-19)
6	Fund-based - ST-Working capital demand loan	ST	75.00	CARE A1+	-	1)CARE A1+ (06-Jan-22)	1)CARE A1+ (08-Jan-21)	1)CARE A1+ (18-Dec-19)
7	Fund-based/Non-fund-based-Short term	ST	-	-	-	1)CARE A1+ (06-Jan-22)	1)CARE A1+ (08-Jan-21)	1)CARE A1+ (18-Dec-19)
8	LT/ST Fund-based/Non-fund-based-PSF/CC/LC/BG	LT/ST*	75.00	CARE AA-; Stable / CARE A1+				

*Long-term/Short-term

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
2	Fund-based - LT-Term loan	Simple
3	Fund-based - LT-Working capital demand loan	Simple
4	Fund-based - LT/ ST-EPC/PSC	Simple
5	Fund-based - ST-Working capital demand loan	Simple
6	Fund-based/Non-fund-based-Short term	Simple
7	LT/ST Fund-based/Non-fund-based-PSF/CC/LC/BG	Simple
8	Non-fund-based - ST-Letter of credit	Simple

Annexure-5: Bank Lender Details

To view the lender-wise details of bank facilities please click here

Note on complexity levels of the rated instrument: *CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.*

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About us:
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