VMS Industries Limited

April 05, 2022

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term / Short Term Bank Facilities	**110.00**	**CARE BBB-; Stable / CARE A3 (Triple B Minus; Outlook: Stable / A Three)**	**Reaffirmed**
Short Term Bank Facilities	**5.50**	**CARE A3 (A Three)**	**Reaffirmed**
Total Facilities	**115.50 (Rs. One Hundred Fifteen Crore and Fifty Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of VMS Industries Limited (VIL) continue to derive strength from its experienced promoters, established and long track record of operations in the ship-breaking industry, its presence at ship breaking yard of Alang in Gujarat, comfortable capital structure and moderate debt coverage indicators alongside adequate liquidity to retire outstanding letter of credits (LCs).

The ratings are, however, constrained on account of susceptibility of its profitability to volatile steel prices & foreign exchange rate fluctuation, its presence in a cyclical ship-breaking industry which is prone to regulatory and environmental hazard risks, moderate scale of operation and thin profitability margins.

Key Rating Sensitivities

Positive Factors:

- Growth in scale of operations along with TOI increase to Rs. 200 crore on a sustained basis
- Improvement in PBILDT margin to more than 5% on a sustained basis
- Improvement in LC coverage ratio above 2x and total debt to gross cash accruals below 10x on a sustained basis

Negative Factors:

- Deterioration in working capital cycle above 90 days on a sustained basis
- Deterioration in overall gearing above 2x and interest coverage ratio below 1.20x on a sustained basis

Detailed description of the key rating drivers

Key Rating Strengths

Extensive experience of the promoter in the ship-breaking industry

The promoter of VIL is one of the oldest in the ship-breaking industry of Alang, Gujarat and has successfully run the business through various business cycles. VIL's promoter Mr. Manoj Kumar Jain (Chairperson and Managing Director) is a qualified chartered accountant with more than two decades of experience in the ship-breaking industry as well as ferrous and nonferrous metal trading business.

Location of yard at Alang having unique geographical features suitable for ship-breaking operations

VIL's ship breaking yard is located at Alang-Sosiya belt which is considered to be one of the largest ship-breaking yards and constitutes almost 90% of India's ship-breaking activity. The unique geographical features of the area include a high tidal range, wide continental shelf, adequate slope and a mud free coast. These conditions are ideal for a wide variety of ships to be beached easily during high tide. The cluster accommodates nearly 153 plots spread over around 10 km long stretch along the sea coast of Alang-Sosiya. VIL has one plot to carry out its ship recycling business at Alang which is leased out by Gujarat Maritime Board (GMB) under a long-term lease agreement.

NK certification of ship recycling facility leading to lower procurement cost of ships

VIL's ship breaking yard has got 'Green Recycling' certification from Nippon Kaiji Kyokai (NK), Tokyo which certifies that its shipyard is compliant with the safe and environmentally sound ship recycling guidelines adopted by the International Maritime Organization (IMO) resolution. This compliance is in relation to adopting more environment friendly practices from an environmental and worker safety point of view, including secure management of hazardous waste generated from the ship-breaking activities. This certification gives VIL an advantage to source a ship at a relatively lower price compared to market rates as major shipping players give preference to companies having green recycling certificate.

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

Comfortable capital structure and moderate debt coverage indicators
The capital structure of VIL improved in FY21 marked by overall gearing of 0.86x as on March 31, 2021 vis-à-vis 2.24x as on March 31, 2020 owing to lower utilization of working capital bank borrowings and lower outstanding LC obligation as on balance sheet date. Further debt coverage indicators continued to remain moderate marked by interest coverage ratio of 1.62x in FY21 vis-à-vis 1.78x in FY20 on account of increase in interest cost with availment of term loan in FY21. Further, LC coverage ratio stood at 1.45 times as on March 31, 2021 as against 1.48 times as on March 31, 2020.

Liquidity: Adequate
VIL's liquidity remained adequate with average utilization of cash credit limit of Rs. 44 crore stood moderate at 47% in the trailing 11 months ended February 2022. Further, its LC coverage ratio stood comfortable 1.48x and 1.29x as on March 31, 2021 and December 31, 2021 indicating sufficient cushion in inventory and fixed deposits vis-à-vis its LC obligations.

Key Rating Weaknesses
Moderate scale of operation and thin profit margins
TOI moderated by 13% on y-o-y basis to Rs.157.74 crore in FY21 from Rs. 181.33 crore in FY20. The income from ship breaking segment had increased by 7% on y-o-y basis while income from trading segment decreased by 42% on y-o-y basis during FY21 due to covid-19 pandemic thus leading to moderation in its scale of operations. VIL's finished products are mainly re-rollable scrap generated from the ship breaking activity. During FY20, the total sales volume of scrap had remained largely stable however there was dip in sales realization on back of similar movement in steel prices. However, with improved sales realization as company had purchased ship in FY20 and sold in FY21 with increased prices of steel, PBILDT margins improved to 3.11% in FY21 vis-à-vis 1.82% in FY20 and achieved net profit of Rs. 1.06 crore vis-à-vis net loss of Rs. 2.20 crore in FY20 VIL's profitability has remained range bound due to low value additive nature of business along with impact of volatile steel prices and forex rates.

Susceptibility of its profitability to volatile steel prices
On purchase of ship, VIL is required to immediately pay entire purchase value of the ship by availing LC limit from the bank whereas its sales happen over a period of time. Accordingly, it is exposed to the volatility in steel prices driven by demand and supply conditions in the global as well as local markets. Accordingly, any adverse price movement on the uncut ship inventory as well as unsold inventory of steel scrap held by the company can impact its profitability.

Exposure to adverse movement in forex rates
The business model of VIL largely requires non-fund based facility i.e. LC which is used to purchase the old ships for ship breaking activity. LC is denominated in foreign currency whereas the company's revenue is denominated in Indian Rupee (INR); hence the company is exposed to forex risk. Earlier, VIL used to estimate its approximate sales value for cut ship for every day and then enter in to a forward contract for an equivalent value of USD on a daily basis to reduce its risk on account of exchange rate fluctuations. However, from FY19 onwards, the company hedges ~70% of its exposure by way of a mix of forward contracts & currency options. Going forward, continuous adherence to the defined hedging policy would be critical. Company has incurred forex loss of Rs. 0.78 crore in FY21 vis-à-vis Rs. 6.53 crore in FY20.

Linkage to cyclicality inherent in the industry
Ship breaking industry is cyclical in nature as supply of old ships for recycling is inversely proportional to freight index. The freight index is a function of global demand of seaborne transport and supply of new vessels which in turn depend on global merchandise trade. Accordingly, there would be better availability of old ships for recycling at the time of recession when freight rates are low which makes it economical to dismantle the ship rather than continue to operate it. In past years, sharp fluctuation in freight index had been observed which had resulted in disruption in operations of ship breakers.

Regulatory and environmental hazard risks
The ship-breaking industry in the Alang-Sosiya belt of Gujarat is highly regulated with strict working and safety standards to be maintained by the ship-breakers for their laborers and environmental compliance. Furthermore, the industry is prone to risks related to pollution as it involves dismantling of ships which contain various hazardous substances like lead, asbestos, acid, hazardous paints, etc. that have to be properly disposed-off as per the regulatory guidelines. Any breach or non-compliance of environment or safety standards could result in discontinuation of ship breaking activity. On the back of second wave of Covid, as majority oxygen supplies were diverted from industrial uses to medical purposes, ship breaking activity of VIL was hampered in April & May-2021.

Analytical approach: Standalone along with factoring corporate guarantee extended to its group company

Applicable criteria
Policy on default recognition
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Wholesale Trading

About the Company

VMS Industries Ltd. (VIL) was originally incorporated as 'Varun Management Services Private Limited' in 1991 and was reconstituted as a limited company with effect from January 2010. VIL came out with an initial public offering in June 2011 and became a listed company. VIL was earlier engaged in providing various consulting & information technology (IT) services and gas supply to the various ship recycling units at Alang, Gujarat. Since May 2009, it is engaged in the ship breaking/recycling activity at Alang, Gujarat which is the leading centre for ship breaking and recycling in Asia. VIL was allotted berth nos. 159 & 160 which was later on merged as berth no. 160-M which has a width of 60 meters with a depth of 45 meters which can handle a vessel with a peak level of 70,000 LDT (Light Displacement Tonnage). VIL is the flagship company of VMS group.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	31-12-2021 (UA)
Total operating income	181.33	157.74	102.71
PBILDT	3.30	4.90	3.23
PAT	-2.20	1.06	1.23
Overall gearing (times)	2.16	0.86	NA
Interest coverage (times)	1.78	1.62	NA

A: Audited, UA: Unaudited, NA: Not Available

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 Instruments / Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG		-	-	-	110.00	CARE BBB-; Stable / CARE A3
Non-fund-based - ST-Credit Exposure Limit		-	-	-	5.50	CARE A3

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	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	LT/ST*	110.00	CARE BBB-; Stable / CARE A3	1)CARE BBB-; Stable / CARE A3 (11-Jun-21)	1)CARE BB+; Stable / CARE A4+; ISSUER NOT COOPERATING* (07-Oct-20)	1)CARE BBB-; Stable / CARE A3 (24-Sep-19)	1)CARE BBB-; Stable / CARE A3 (23-Jul-18)
2	Non-fund-based - ST-Credit Exposure Limit	ST	5.50	CARE A3	1)CARE A3 (11-Jun-21)	1)CARE A4+; ISSUER NOT COOPERATING* (07-Oct-20)	1)CARE A3 (24-Sep-19)	1)CARE A3 (23-Jul-18)

* Long Term / Short Term

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: Not available

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	Simple
2	Non-fund-based - ST-Credit Exposure Limit	Simple

Annexure 5: Bank Lender Details for this Company
To view the lender wise details of bank facilities please **click here**

Note on complexity levels of the rated instrument: CARE Ratings Ltd. 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.

Contact us

Media Contact
Name: Mradul Mishra
Contact no.: +91-22-6754 3573
Email ID: mradul.mishra@careedge.in

Analyst Contact
Name: Parijat Sinha
Contact no.: 9769398029
Email ID: parijat.sinha@careedge.in

Relationship Contact
Name: Deepak Purshottambhai Prajapati
Contact no.: +91-79-4026 5656
Email ID: deepak.prajapati@careedge.in

About CARE Ratings Limited:
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With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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