VMS Industries Limited

January 06, 2023

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term / Short Term Bank Facilities	138.00 (Enhanced from 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 Bank Facilities	**143.50 (₹ One Hundred Forty-Three Crore and Fifty Lakhs Only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of VMS Industries Limited (VIL) continue to derive strength from its extensive experience of promoters in the ship breaking industry, established and long track record of operations in the ship-breaking industry, its presence at ship breaking yard of Alang in Gujarat and adequate liquidity. The ratings also factor in moderation in capital structure and debt coverage indicators in FY22 (FY refers to the period from April 1 to March 31).

The ratings are, however, constrained on account of its moderate scale of operation and thin profitability which declined in FY22, 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.

Rating sensitivities

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

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

- Deterioration in LC coverage below 1.10 times
- Deterioration in working capital cycle above 100 days on a sustained basis
- Deterioration in overall gearing above 2x

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. Promoters has promoted another company namely VMS TMT private limited which is engagement in manufacturing of TMT bars.

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 constitutes nearly 90% of India's ship-breaking activities and it is India's largest ship-breaking cluster. 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 170 plots spread over around 10 km long stretch along the seacoast of Alang-Sosiya (Source: Gujarat Maritime Board). VIL has one plot to carry out its ship recycling business at Alang which is leased out by Gujarat Maritime Board (GMB) on a 10-year lease which gets renewed on expiry.

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

VIL complied to "Green recycling - Guidelines for Safe and Environmentally Sound Ship Recycling, adopted by IMO resolution MEPC.210 (63)" which is certified by Nippon Kaiji Kyokai, Tokyo on April 22, 2019, valid till April 2024. These compliances are in

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

relation to adopting more environment friendly practices and results in lower procurement cost of ships as major shipping players give preference to companies with ship recyclers with green recycling certificate.

Moderation in its structure and debt coverage indicators during FY22

The capital structure of VIL deteriorated in FY22 marked by overall gearing of 1.40x as on March 31, 2022, vis-à-vis 0.86x as on March 31, 2021, owing to higher utilization of working capital borrowings and LC which utilised higher due to substantial increase in trading activity in Q4 coupled with higher inventory level of uncut ship as at the year end. Further, adjusted overall gearing (including guaranteed debt in total debt and excluding investment in group entity from networth) remained at moderate at 1.57x as on March 31, 2022. However, overall gearing improved to 0.57x as on September 30, 2022, on the back of lower ship breaking activities and sale of uncut ship inventory amidst correction in steel scrap prices in H1FY23.

Further, debt coverage indicators also deteriorated marked by negative interest coverage ratio in FY22 vis-à-vis 0.15x in FY21 on account of negative PBILDT margin. However, LC coverage ratio (only ship breaking LC) remained comfortable at 1.30 times as on March 31, 2022 as against 1.45 times as on March 31, 2021.

Key rating weaknesses

Moderate scale of operation and thin profitability

TOI grew marginally by 3% on y-o-y basis at Rs.158.87 crore in FY22 from Rs. 154.15 crore in FY21 despite of dip of revenue in the ship breaking industry with increased trading activity. The income from ship breaking segment had decreased by 23% on y-o-y basis mainly on the back of lower ship breaking activity amidst volatility in steel prices while income from trading segment by 72% on y-o-y basis during FY22. This coupled with increased freight cost on traded goods led to losses at PBILDT levels. 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. However, company had earned good interest income on L&A given to group companies and third parties resulting in stable PAT levels in FY22. During H1FY23, it has reported further decline in PBILDT levels on y-o-y basis with adverse movement in steel prices. Further, during H1FY23, TOI improved to Rs.75.30 crore in H1FY23. However, PBILDT margin continued to remain thin at 0.32%.

Susceptibility of its profitability to volatile steel scrap 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. 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 foreign exchange rates

The business model of VIL largely requires non-fund-based facility i.e. Letter of Credit (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.

VIL hedges its foreign exchange exposure via a combination of forward contracts, derivatives and options for the ship purchased. Around 80-100% of the total exposure of VIL is hedged through a combination of forward contracts, derivatives and options. Going forward, continuous adherence to the defined hedging policy would be critical. Company has incurred forex gain of Rs. 0.48 crore in FY22 vis-à-vis Rs. loss of Rs.0.78 crore in FY21.

Linkage to cyclicality inherent in the industry coupled with intense competition from neighbouring countries

The ship breaking industry is cyclical in nature as supply of old ships for recycling is inversely proportional to freight rates in the global economy. These freight rates take into account the global demand of seaborne transport and supply of new vessels which in turn depends on global merchandise trade. So better availability of old ships for recycling is ensured at the time of recession and when freight rates are low which makes it economical to dismantle the ship rather than continue to operate it. The movement in the freight prices is indicated by the Baltic Dry Index (BDI), basically a shipping and trade index. However, increased trade volumes post disruptions caused by Covid-19 pandemic and upward freight rates, which albeit moderated recently, supports profitability of sailing vessels, thus limiting availability of ships for dismantling.

The Indian ship-recycling yard face intense competition from the neighbouring countries like Bangladesh and Pakistan due to availability of low wage labour, lower health, and environment related regulations.

Liquidity: Adequate

VIL's liquidity remained adequate with average working capital utilization of 50% for the past 12 months ended November 2022. Further, its LC coverage ratio stood comfortable 1.30x and 1.45x as on March 31, 2022, and March 31, 2021 respectively, indicating sufficient cushion in inventory and fixed deposits vis-à-vis its LC obligations. However, DSCR stood low and require funds release from working capital changes/L&A given for timely debt repayment. It is expected to generate a GCA of Rs.1-2 crore which is tightly matched against repayment obligation of around Rs.2 crore in near term. It has cash and bank balance of Rs.0.24 crore and FDs of Rs.19.29 crore which are lien marked against LC's as on March 31, 2022.

VIL largely requires non-fund based working capital limit in the form of LC/BC for the sole purpose of purchasing the ships for ship breaking activity. The company has also reserved a certain limit of LC as sublimit for its steel trading business wherein the margins are however low. The tenure for the same depends upon the size of the ships and ranges from anywhere between 90-300 days. With the ongoing ship breaking activity, it needs to build up FD with its LC banker as per given schedule by the banker. These FDs are lien marked against the LC/BC obligation. This mechanism ensures gradual build up of reserve funds to meet the LC/BC obligations on maturity date. VIL has to keep 10% as LC margin. Further, it requires fund based working capital limit to pay upfront customs duty & GST on ship price which is usually squared up within 3 months of commencement of ship breaking activity. Also, for any unforeseen reasons, if there is any delay in ship breaking activity and it is unable to create FD as per stipulation w.r.to outstanding LC exposure, lenders allow to use CC limit for FD creation up to 30% of its total requirement for FD creation.

Analytical approach: Standalone along with factoring corporate guarantee extended to its group company viz. Eternal Automobiles.

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
Wholesale Trading
Policy on Withdrawal of Ratings

About the company

VMS Industries Limited (VIL: L74140GJ1991PLC016714) 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 public limited company. VIL was earlier engaged in providing various consulting and information technology (IT) services like computerization of land revenue records, ration cards and ration shops for Bhavnagar Municipal Corporation and providing gas supply to the various ship recycling units at Alang, Gujarat. However, since FY10, 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 160M to handle a peak level of 70,000 LDT (Light Displacement Tonnage). VIL is the flagship company of VMS group. Further, VIL trade into steel and iron scrap, ingots and billets on an order basis, as and when there is no ship available for cutting in order to maintain relationship with existing customers and labour at site.

VIL provided corporate guarantee for working capital loan availed by M/s. Eternal Automobiles (VIL holds 10% share in partnership firm as on March 31, 2022) of Rs.3.50 crore as on March 31, 2022.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23 (UA)
Total operating income	154.15	158.87	75.30
PBILDT	1.31	-0.45	0.24
PAT	1.06	1.09	0.71
Overall gearing (times)	0.86	1.40	0.57
Adjusted overall gearing(times)*	0.99	1.57	NA
Interest coverage (times)	0.43	-0.23	0.29

A: Audited; UA: Unaudited; figures have been restated whenever necessary; NA: Not Available

*Adjusted including guaranteed debt of Eternal Automobiles in total debt and excluding investment in group entities from tangible net worth

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: 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 (₹ crore)	Rating Assigned along with Rating Outlook
LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG		-	-	-	138.00	CARE BBB-; Stable / CARE A3
Non-fund-based - ST-Credit Exposure Limit		-	-	-	5.50	CARE A3

Annexure-2: Rating history for the 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	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	LT/ST*	138.00	CARE BBB-; Stable / CARE A3	1)CARE BBB-; Stable / CARE A3 (05-Apr-22)	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)
2	Non-fund-based - ST-Credit Exposure Limit	ST	5.50	CARE A3	1)CARE A3 (05-Apr-22)	1)CARE A3 (11-Jun-21)	1)CARE A4+; ISSUER NOT COOPERATING* (07-Oct-20)	1)CARE A3 (24-Sep-19)

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: None

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 instruments: 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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