VMS Industries Limited

June 11, 2021

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long Term / Short Term Bank Facilities	110.00	**CARE BBB-; Stable / CARE A3 (Triple B Minus; Outlook: Stable / A Three)**	**Ratings removed from ISSUER NOT COOPERATING category and Revised from CARE BB+; Stable / CARE A4+; (Double B Plus; Outlook: Stable / A Four Plus)**
Short Term Bank Facilities	5.50	**CARE A3 (A Three)**	**Rating removed from ISSUER NOT COOPERATING category and Revised from CARE A4+; (A Four Plus)**
Total Facilities	**115.50 (Rupees One Hundred Fifteen Crore and Fifty Lakh Only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities of VMS Industries Limited (VIL) factors sequential growth in its revenue from ship-breaking segment on a q-o-q basis during 9MFY21 along with improvement in its profitability during 9MFY21 vis-à-vis FY20 as per details shared by the company after it again started co-operating with CARE and provided requisite financial and operational information for monitoring of its ratings. The ratings further 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, moderate capital structure and 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, thin profitability margins and adverse impact of second wave of Covid-19 on its operations. CARE also takes cognizance of VIL availing moratorium on its debt as a Covid relief measure, in line with Reserve Bank of India (RBI) guidelines, for servicing of its bank facilities.

<u>Rating Sensitivities</u>

Positive factors

- Growth in scale of operations along with improvement in PBILDT margin to more than 5% on a sustained basis
- Realisation of inter-corporate loans given by VIL
- Improvement in LC coverage ratio to above 1.50x on a sustained basis

Negative factors

- Prolonged disruption in operations due to Covid impacting its liquidity and cash flows
- Deterioration in LC coverage ratio below 1.10x on a sustained basis (considering the stipulation of 10% margin by the lender for LCs)
- Extension of sizeable loans and advances to other entities along with delay in scheduled build-up of FDs against outstanding LC repayment obligation

Detailed description of the key rating drivers

<u>Key Rating Strengths</u>

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.

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

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.

Moderate capital structure and debt coverage indicators
The capital structure of VIL marked by overall gearing had deteriorated to 2.10 times as on March 31, 2020 compared with 1.66 times as on March 31, 2019 mainly upon procurement of high value ship during February 2020 and LC opened for steel trading purpose leading to higher availment of LC limit at the end of the year. VIL had no term loan except marginal vehicle loans till FY20; however, the company availed term loan of Rs.8.05 crore during Q4FY21 under Guaranteed Emergency Credit Line (GECL) scheme from its lender. VIL's adjusted overall gearing (i.e. including the corporate guarantees extended for the bank facilities of group companies and reducing VIL's net-worth for the investments & loans given to its group companies) had also moderated and stood at 4.12 times as on March 31, 2020 as against 3.02 times as on March 31, 2019 owing to higher debt levels coupled with increase in inter corporate advances which stood at Rs.22.45 crore as on March 31, 2020 as against Rs.11.46 crore as on March 31, 2019. The inter corporate advances had further gone up to Rs.39.46 crore as on March 31, 2021. Debt coverage indicators also stood moderate with interest coverage (PBILDT/interest) and Total debt/PBILDT at 1.78x and 33.83x as on March 31, 2020 as compared with 5.37x and 22.31x as on March 31, 2019 respectively. VIL had one subsidiary i.e. VMS TMT Pvt. Ltd. (VTPL) in which VIL held 80.13% shareholding upto August 30, 2019. VIL liquidated its investment in VTPL during FY20 by 61.17% and hence VIL ceased to be holding company of VTPL. Also, the corporate guarantee extended by VIL for the bank facilities of VTPL now stands withdrawn.

Liquidity*: Adequate*
VIL's liquidity stood adequate with moderate utilization of working capital limits at 61% in the trailing 12 months ended March 2021. Further, its LC coverage (marked by inventory of uncut ship & available fixed deposits vis-à-vis outstanding LC obligation) stood comfortable at 1.56x and 1.41x as on March 31, 2020 and March 31, 2021 respectively. However, as there was meagre ship breaking activity in Q1FY21 due to Covid-19 induced lockdown, VIL availed moratorium on its bank facilities as a Covid relief measure, in line with Reserve Bank of India (RBI) guidelines. VIL parks its excess funds in the form of inter-corporate deposits which carry a fair degree of uncertainty about its timely realization although they are repayable on call.
VIL largely requires non-fund based working capital limit in the form of LC/BC (Buyers Credit) for the sole purpose of purchasing the ships for undertaking 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 of the LC/BC depends upon the size of the ships and normally ranges 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 additionally keep 10% of the LC value as LC margin. Further, it also has sanctioned fund based working capital limit which is normally used to pay upfront customs duty & GST on ship price and is usually squared up within 3 months of commencement of ship breaking activity. Further, VIL is expected to service its term debt repayment obligation pertaining to GECL loan from its cash flow from operations and/or realization of inter corporate loans, if required.

Key Rating Weaknesses
Moderation in scale of operations during 9MFY21 and thin profitability margins; albeit sequential quarterly growth in its ship-breaking activity in 9MFY21
The TOI of VMS moderated by 29% on y-o-y basis to Rs.104.46 crore during 9MFY21. While the income from trading segment decreased by ~40% on y-o-y basis during 9MFY21 that from its ship-breaking segment declined by ~25% on a y-o-y basis during 9MFY21 primarily owing to meagre ship breaking activity in Q1FY21 due to Covid-19 induced lockdown; however, its ship-breaking activity subsequently picked-up on a sequential basis during Q2FY21 and Q3FY21.

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. It reported net loss of Rs.2.20 crore along with cash losses during FY20 due to decline in its operating profitability, booking of hedging cost of the LC opened for newly procured ship in Feb. 2020 and on account of prior period items of Rs.3.41 crore which included income tax of earlier years of Rs.2.52 crore paid by the company under 'The Direct Tax Vivad se Vishwas Act, 2020' in respect of disputed Income tax liabilities pertaining to past years. However, its operations again turned profitable during 9MFY21 wherein it reported a net profit of Rs.0.73 crore.

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.

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:
Criteria on assigning Outlook and Credit Watch to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology-Manufacturing Companies
Rating Methodology-Trading Companies
Financial ratios – Non-Financial Sector
Liquidity Analysis of Non-Financial Sector

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)	FY19 (A)	*FY20 (A)
Total operating income (TOI)	179.97	181..33
PBILDT	4.13	3.30
PAT	1.98	# (2.20)
Overall Gearing (times)	1.66	2.10
Interest coverage (times)	5.37	1.78

A: Audited
**FY20 figures have been restated wherever necessary;*
#post prior period items of Rs.3.41 crore which included income tax of earlier years of Rs.2.52 crore paid by the company under 'The Direct Tax Vivad se Vishwas Act, 2020' in respect of disputed Income tax liabilities pertaining to past years.

As per published results for 9MFY21, VIL reported TOI of Rs.104.46 crore (9MFY20: Rs.146.94 crore) with a PAT of Rs.0.73 crore (9MFY20: Rs.1.14 crore).

Status of non-cooperation with previous CRA: CRISIL has moved the rating assigned to the bank facilities of the company to 'Issuer not cooperating' category vide press release dated August 21, 2020 in absence of requisite information.
Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Complexity level of various instruments rated for this company: Please refer Annexure-3

Annexure - 1: Details of Facilities

Name of the Instrument/ Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Non-fund-based - LT/ ST-Letter of credit	-	-	-	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.	Non-fund-based - LT/ ST-Letter of credit	LT/ST	110.00	CARE BBB-; Stable / CARE A3	-	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 A4+; ISSUER NOT COOPERATING* (07-Oct-20)	1)CARE A3 (24-Sep-19)	1)CARE A3 (23-Jul-18)

** Issuer did not cooperate; based on best available information*

Annexure 3: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Non-fund-based - LT/ ST-Letter of credit	Simple
2.	Non-fund-based - ST-Credit Exposure Limit	Simple

***Note on complexity levels of the rated instrument:** CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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