VMS Industries Limited

December 26, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term / Short Term Bank Facilities	138.00	CARE BBB-; Stable / CARE A3	Reaffirmed
Short Term Bank Facilities	5.50	CARE A3	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The ratings assigned to the bank facilities of VMS Industries Limited (VIL) continue to derive strength from experienced promoters with long track record of operations in the ship recycling industry, its presence at yard at Alang and NK certification of ship recycling facility leading to low procurement cost of ships. The ratings also factor in its moderate capital structure in FY23 (Audited; FY refers to the period from April 1 to March 31) and adequate liquidity with adequate Letter of credit (LC) coverage ratio in FY23 and H1FY24 (Unaudited; refers to the period from April 1 to September 30).

The ratings are, however, constrained on account of its moderate scale of operation and thin profitability, exposure to adverse movement in steel prices and forex rates, its presence in cyclical ship recycling industry with competition of global peers and exposure to regulatory and environment hazard risk.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Growth in scale of operations along with Total operating income (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 LC coverage below 1.10x
- Deterioration in working capital cycle above 100 days on a sustained basis

Analytical approach: Standalone

Analytical approach has been changed from 'standalone along with factoring corporate guarantee extended to its group company' to 'Standalone' on withdrawal of corporate guarantee extended to Eternal automobiles (EA), its group company.

Outlook: Stable

The outlook on the long-term rating of VIL is "Stable" considering the long experience of the promoters in the industry along with the advantage of location being presence in the Alang -Sosiya region.

Detailed description of the key rating drivers:

Key strengths

Experienced promoters with long track record of operations in the ship recycling industry

The promoter of VIL is one of the oldest in the ship-recycling 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 almost three decades of experience in the ship-recycling industry as well as ferrous and nonferrous metal trading business. Promoters has promoted another company namely VMS TMT private limited (VTPL) which is engaged in manufacturing of TMT bars.

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

VIL's ship recycling yard is located at Alang-Sosiya belt, which constitutes nearly 90% of India's ship-recycling activities and it is India's largest ship-recycling 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 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.

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

Moderate capital structure and debt coverage indicators

The capital structure of VIL improved in FY23 but continue to remain moderate marked by overall gearing of 0.50x as on March 31, 2023, vis-à-vis 1.40x as on March 31, 2022, owing to no ship recycling LC outstanding as at the year end with lower ship recycling activity in FY23. Further, adjusted overall gearing (including guaranteed debt extended to EA as on March 31, 2022 and excluding investment/loans and advances extended from net worth and excluding margin money from total debt) remained at 0.47x as on March 31, 2023 as against 2.90x as on March 31, 2022. Adjusted overall gearing improved upon discontinuation of extension of corporate guarantee to EA and sale of investments in EA and VTPL. However, the same moderated to 1.01x as on September 30, 2023, on the back of ship recycling LC o/s as against uncut ship inventory.

Further, debt coverage indicators improved with improvement in profitability marked by interest coverage ratio of 0.41x in FY23 vis-à-vis negative interest coverage in FY22.

Key weaknesses

Moderate scale of operations and thin profitability

Revenue from ship recycling activity of VIL remained fluctuating depending upon the availability of ship for cutting along with the volatility associated with steel scrap prices. In FY23, TOI declined by 11% on y-o-y basis but continue to remain moderate at Rs.141.42 crore from Rs. 158.87 crore in FY22 mainly owing to dip in ship recycling activity. The income from ship recycling segment has decreased by 41% on y-o-y basis as against income from trading segment has increased by 24% on y-o-y basis during FY23. In FY23, revenue from ship recycling activity remained lowest of past 5 years ended FY23 mainly owing to increased freight cost coupled with increased competition from global peers limiting availability of ships for dismantling and volatility in steel prices. VIL has not purchased any ship during FY23 and entire revenue from ship recycling activity has derived from sale of uncut ship inventory of FY22.

Further, during H1FY24, VIL reported TOI of Rs.100.95 crore (Rs.47 crore from ship recycling and Rs.54 crore from trading segment). In June 2023, VIL entered into a ship purchase agreement with Welspun Corp Limited (WCL; rated CARE AA; Negative/ CARE A1+) to purchase and demolish 11 under construction ships and 493 ship blocks within 14 months (till Aug-24) having estimated aggregate weight of 48,000 tons starting from July 2023, at WCL's shipyard located in Dahej, Gujarat, which reflects revenue visibility in FY24 and H1FY25. Sustainability of increase in scale of operations from its core business is key rating monitorable.

In terms of profitability, it continues to remain thin in FY23 as well. VIL registered PBILDT margin of 0.67% in FY23 as against operating loss of Rs.0.45 crore in FY22 owing to higher sales realisation coupled with lower labour cost related to ship recycling activity. Consequent to increase in operating profit coupled with higher interest income on L&A extended resulted in improved PAT margin in FY23 at 1.67% as against 0.69% in FY22. With high margin contract with WCL in Q2FY24, VIL has registered improvement in PBILDT margin at 2.97% in H1FY24 and it is expected to remain in the same line in FY24.

Exposure to adverse movement in steel prices and forex rates

The volatility in steel prices driven by demand and supply conditions in the global as well as local markets exposes VIL to any adverse price movement on the uncut ship inventory as well as unsold inventory of steel scrap held by the company (which generally remains minimal). The steel prices started correcting gradually from June 2022 after touching its peak in FY22 owing to weak global demand especially from the largest consumer- China. Further, the decline in coking coal prices also led to the fall in steel prices. Overall, the global steel prices averaged at around USD 672 per ton in FY23, a decline of 22.4% on a y-o-y basis. The prices further declined in April-May 2023 due to weak global demand. Domestic steel prices have followed global prices directionally.

The company uses the LC facility to purchase old ships. Since the transactions are denominated in foreign currency as against revenue in Indian Rupee (INR), it is exposed to forex risk during the LC Usance period. VIL hedges its foreign exchange exposure via a combination of forward contracts, derivatives and options for the ship purchased. VIL has incurred forex loss of Rs.1.40 crore in FY23 vis-à-vis forex gain of Rs. 0.48 crore in FY22. Forex gain/loss has impacted PBILDT margin to the extent of 1-4% over the past five years ended FY23.

Cyclicality associated with ship recycling industry coupled with competition of global peers

The ship recycling 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. 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. Owing to the decline in freight rates better ship availability is expected in H2FY24. Further, Indian ship-recycling yard face intense competition from the neighbouring countries like Bangladesh and Pakistan.

Exposure to Regulatory and Environment hazard risk

The ship recycling industry in the Alang-Sosiya belt of Gujarat is highly regulated with strict working and safety standards to be maintained by the ship recyclers for their labourers 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, acids, hazardous paints, etc. that have to be properly disposed -off as per the regulatory guidelines.

Liquidity: Adequate
VIL's liquidity remained adequate with low combined month end fund based and non-fund based working capital utilization of 21% for the past 12 months ended October 2023, adequate LC coverage ratio and modest free cash and bank balance. LC coverage ratio considering trading and ship recycling LC continue to remain adequate marked by 1.87x as on March 31, 2023. Further, as on September 30, 2023, LC coverage continue to remain adequate, indicating sufficient cushion in inventory and fixed deposits vis-à-vis its LC obligations. Further, VIL is expected to generate GCA of around Rs.5 crore as against repayment obligation of Rs.1.63 crore in FY24. However, in case of exigency, repayment is expected to be funded through release of funds from L&A given or from working capital management for timely debt repayment.
VIL largely requires a non-fund based working capital limit in the form of LC/BC for the sole purpose of purchasing ships for ship recycling 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 recycling 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 buildup 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 recycling activity. Also, for any unforeseen reasons, if there is any delay in ship recycling 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.

Applicable criteria

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

About the company and industry

Industry classification

Macro-Economic Indicator	Sector	Industry	Basic Industry
Services	Services	Commercial Services & Supplies	Trading & Distributors

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 recycling activity at Alang, Gujarat which is the leading centre for ship recycling 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.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	H1FY24 (UA)
Total operating income	158.87	141.42	100.95
PBILDT	-0.45	0.67	3.00
PAT	1.09	2.37	2.05
Overall gearing (times)	1.40	0.50	1.01
Interest coverage (times)	-0.23	0.41	1.97

A: Audited UA: Unaudited; Note: 'the above results are latest financial results 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: Annexure-4
Lender details: Annexure-5

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 2023-2024	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
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 (06-Jan-23) 2)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)
2	Non-fund-based - ST-Credit Exposure Limit	ST	5.50	CARE A3	-	1)CARE A3 (06-Jan-23) 2)CARE A3 (05-Apr-22)	1)CARE A3 (11-Jun-21)	1)CARE A4+; ISSUER NOT COOPERATING* (07-Oct-20)

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities: Not Applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the 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: Lender details

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

Note on the 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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