VMS Industries Ltd

July 23, 2018

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]**	**Assigned**
Short Term Bank Facilities	5.50	**CARE A3 [A Three]**	
Total	**115.50 (Rupees One hundred Fifteen crore and Fifty lakh Only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of VMS Industries Ltd (VIL) derive strength from its experienced promoters, established and long track record of operation in the ship-breaking industry, its presence at ship breaking yard of Alang in Gujarat, comfortable capital structure, moderate debt coverage indicators and adequate liquidity to retire outstanding letter of credits (LCs) on the back of recouping part of its funds advanced as Inter Corporate Deposits (ICDs).
The ratings are, however, constrained on account of susceptibility of its profitability to volatile steel prices & foreign exchange fluctuation, its presence in a cyclical ship-breaking industry which is prone to regulatory and environmental hazard risks.
VIL's ability to increase its scale of operations, improve its profitability along with maintaining comfortable capital structure and adequate build-up of Fixed Deposits w.r.to outstanding LC obligation would be the key rating sensitivities.

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 (Managing Director) is a qualified chartered accountant with more than two decades of experience in the ship-breaking industry as well as ferrous and non-ferrous 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 including a high tidal range, wide continental shelf, 15 degree slope, and a mud free coast are ideal for any size of ship to be beached easily during high tide. It accommodates nearly 165 plots spread over around 10 km long stretch along the sea coast of Alang. 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.

Growth in scale of operations with moderate profitability

During the last 3 years-ended FY18, VIL's TOI grew by 12% CAGR to Rs.120.71 crore during FY18 (Prov.) from Rs.85.98 crore during FY15. During FY18, TOI grew marginally by 2.7% over the previous year due to volatile market scenario. Nevertheless, the sales realisation has improved by 18% supported by improving trend in steel prices. The growth in total sales is also supported by increased trading income which is recorded at Rs.46.65 crore during FY18 (Prov.) compared to Rs.20.59 crore during FY17 and interest income from the loans & advances given to other entities during FY18. 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. During FY18 (Prov.) PBILDT margin improved by ~100 bps to 3.27% from 2.22% in FY17 mainly because of increasing trend in steel prices. Simultaneously, PAT margin also improved by 33 bps to 1.17% in FY18 from 0.84% in FY17.

Comfortable capital structure, moderate debt coverage indicators and adequate liquidity

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

Overall gearing of VIL on net debt basis (i.e. netting off its total debt against the available fixed deposits & cash balance) is comfortable at 0.87 times as on March 31, 2018 compared to 0.92x as on March 31, 2017. The capital structure of VIL has remained comfortable on the back of better capitalization of the company aided by its IPO long back. Debt coverage indicators remained moderate with interest coverage (PBILDT/interest) and TDGCA (on net debt basis) at 2.75x and 24.80x as on March 31, 2018 as compared to 6.08x and 31.88x as on March 31, 2017. Its liquidity indicator marked by Letter of Credit (LC) coverage backed by inventory of uncut ship & available fixed deposits improved as on June 30, 2018 on account of recouping part of its funds given as Inter Corporate Deposits (ICDs) during FY18 & Q1FY19.

Key Rating Weaknesses

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 it's 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 for 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. 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. As a practice, VIL estimates its approximate sales value for cut ship for every day and then enters 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. During FY18, VIL incurred loss of Rs.0.55 crore on account of forex fluctuations.

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 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, 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.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology-Manufacturing Companies
Financial ratios – 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, 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 center 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 peak level of 70,000 LDT (Light Displacement Tonnage). VIL is the flagship company of VMS group and it operates along with its subsidiary VMS TMT Pvt Ltd. which is engaged in the trading of steel bars, ingots and billets.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)	FY18 (Prov.)
Total operating income	105.98	117.54	120.71
PBILDT	3.02	2.61	3.94
PAT	0.95	0.99	1.41
Overall gearing (times)*	0.59	0.92	0.87
Interest coverage (times)	2.27	6.08	2.75

*A: Audited; Prov: Provisional; *by reducing total debt for the FDs kept as margin for LC/BC*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not applicable

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

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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****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**

About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-I: Details of Instruments/Facilities

Name of the Instrument	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	NA	NA	NA	110.00	CARE BBB-; Stable / CARE A3
Non-fund-based - ST-Credit Exposure Limit	NA	NA	NA	5.50	CARE A3

NA: Not applicable

Annexure-II: 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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Non-fund-based - LT/ ST-Letter of credit	LT/ST	110.00	CARE BBB-; Stable / CARE A3	-	-	-	-
2.	Non-fund-based - ST-Credit Exposure Limit	ST	5.50	CARE A3	-	-	-	-

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