# VMS Industries Ltd

September 24, 2019

**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)** | **Reaffirmed** |
| Short Term Bank Facilities | 5.50 | **CARE A3 (A Three)** | **Reaffirmed** |
| **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) continue to 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, growth in scale of operations, moderate capital structure and debt coverage indicators alongside 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 rate 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 its capital structure and adequate build-up of Fixed Deposits in a disciplined manner 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.

***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, Tokyo which certifies that VIL's shipyard is compliant to the safe and environmentally sound ship recycling guidelines adopted by IMO resolution MEPC.210 (63). 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.

***Growth in scale of operations on the back of higher volume of ship recycling activity & trading activity during FY19***

VIL's TOI grew by ~40% from Rs.120.71 crore during FY18 to Rs.179.97 crore during FY19; primarily aided by increase in steel prices during the year & higher volume of ship breaking activity during the year. The growth in TOI was also supported by increased trading income which increased to Rs.57.76 crore during FY19 compared to Rs.46.65 crore 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. The spread in ship breaking activity declined during FY19 leading to moderation in its

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

profitability margins, however with growth in scale of operations, profitability in absolute terms improved during the year.

***Moderate capital structure and debt coverage indicators***

VIL does not have any term loan except marginal vehicle loans; however total debt is mostly comprised of the outstanding LC obligations against the ships purchased. The capital structure of VIL moderated marked by an overall gearing of 1.66 times as on March 31, 2019 compared to 1.10 times as on March 31, 2018 mainly upon procurement of high value ship during Feb. 2019 leading to higher availment of LC limit at the end of the year.

VIL's adjusted overall gearing (i.e. including the corporate guarantees given by it for the bank facilities of VMS TMT Pvt. Ltd. & group companies and reducing VIL's net-worth for the investments & loans given to its group companies) stood stable at 3.02 times as on March 31, 2019 & March 31, 2018.

Debt coverage indicators remained moderate with interest coverage (PBILDT/interest) and TDGCA stood at 5.37x and 37.91x as on March 31, 2019 as compared to 2.75x and 31.50x as on March 31, 2018 respectively.

***Liquidity analysis***

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 ship breaking activity. The tenure of the same depends upon the size of the ships and 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 buildup 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 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. VIL's liquidity position remained comfortable as indicated by its LC Coverage (marked by inventory of uncut ship & available fixed deposits vis-à-vis outstanding LC obligation) of 1.51 times as on March 31, 2019 compared to 1.09 times as on March 31, 2018.

**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 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. 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. 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, during FY19 for the ship procured in Feb. 2019, it has hedged ~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.

**Analytical approach:** Standalone along with factoring corporate guarantees extended to its two group companies.

**Applicable Criteria**

[Criteria on assigning Outlook 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]

**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 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 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) | FY18 (A) | FY19 (A) |
|---|---:|---:|
| Total operating income | 120.71 | 179.97 |
| PBILDT | 3.94 | 4.13 |
| PAT | 1.41 | 1.98 |
| Overall gearing (times) | 1.10 | 1.66 |
| Interest coverage (times) | 2.75 | 5.37 |

*A: Audited*

As per Q1FY20 provisional results, VIL reported a TOI of Rs.36.91 crore with a PAT of Rs.0.40 crore.

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating History (Last three years):** Please refer Annexure-2

**Annexure-1: 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 | - | - | - | 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 2019-2020 | Date(s) & Rating(s) assigned in 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 |
| 1. | Non-fund-based - LT/ ST-Letter of credit | LT/ST | 110.00 | CARE BBB-; Stable / CARE A3 | - | 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 (23-Jul-18) | - | - |

***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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