

May 23, 2019

Variety Lumbers Private Limited: Rating upgraded to [ICRA]C/A4

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|--|-----------------------------------|----------------------------------|---------------------------------|
| Fund-based Cash Credit | 2.00 | 2.00 | [ICRA]C; Upgraded from [ICRA]D |
| Non-fund-based Import Letter of Credit cum Buyers Credit | 20.00^ | 20.00 | [ICRA]A4; Upgraded from [ICRA]D |
| Total | 22.00 | 22.00 | |

*Instrument details are attached in Annexure-1

^Includes sublimit: BELC (Rs. 4.00 crore) and BG (Rs. 1.00 crore)

Rationale

The ratings revision takes into account the regularisation of debt servicing in the past four months with an improvement in the liquidity position. The ratings favourably factor in the extensive experience of Variety Lumbers Private Limited's (VLPL) promoters in the timber industry and location-specific advantages due to its proximity to the Kandla port in Gujarat.

The ratings, however, remain constrained by the company's weak financial risk profile, marked by a leveraged capital structure, weak coverage indicators and tight liquidity position owing to high working capital intensity of 31% as on FY2019-end. ICRA notes that the inventory days increased to 97 days in FY2019 compared to 58 days as on FY2018-end due to temporary labour shortage, though the same is expected to smoothen in the near term. Further, the ratings factor in the stiff competition in the timber industry and the vulnerability of VLPL's profitability to volatility in timber prices and to foreign exchange fluctuation on the back of substantial imports.

Key rating drivers

Credit strengths

Extensive experience of promoters in the timber industry – Incorporated in 2002, VLPL's operations are managed by the members of the Dubey family, who have more than two decades of experience in the timber business.

Location-specific advantage – VLPL's facility is located at Gandhidham in Gujarat, which has been declared a timber zone by the Government. Further, a major part of its procurement is through imports. Thus, proximity to the Kandla port in Gujarat provides logistical advantage to the company.

Regularisation in debt servicing – The company has been regular in making debt repayment to its lenders since the last four months (i.e. January 2019 – April 2019) owing to an improvement in its liquidity position.

Credit challenges

Weak financial risk profile characterised by leveraged capital structure and weak coverage indicators – Low value addition in timber sawing and trading business results in low operating margin (4.7% in FY2018) and net margin (0.9% in FY2018). VLPL’s capital structure continues to remain leveraged, with a gearing of 2.3 times as on FY2018-end and 2.7 times as on FY2017-end. The debt coverage indicators remained weak with interest coverage of 1.4 times, TD/OPBIDTA of 4.3 times, DSCR of 1.3 times and NCA/TD of 6% as on FY2018-end as against interest coverage of 1.3 times, TD/OPBIDTA of 8.6 times, DSCR of 1.2 times and NCA/TD of 3% as on FY2017-end. Further, its operating income (OI) declined by 14% to Rs. 37.8 crore in FY2019 (provisional numbers) from Rs. 43.9 crore in FY2018.

Stretched liquidity position – VLPL’s working capital intensity increased substantially in FY2019 due to an increase in inventory holding to 97 days in FY2019 from 58 days in FY2018, leading to an increase in its working capital intensity as reflected by a NWC/OI of 31% as on FY2019-end compared to 20% as on FY2018-end. Limited production because of shortage of labour resulted in pile up of raw material inventory. The overall liquidity position remains tight with LC repayments due in the near term and limited cushion in the working capital limits, though normalisation in labour availability and expected receipt from debtors is likely to support its liquidity.

Intense competition due to presence of numerous players – Timber sawing and trading is a low value-added business with stiff competition from numerous players operating in the fragmented industry, which keeps the margins under check.

Exposure to Government regulations of the importing country; volatility in timber prices – A predominant share of VLPL’s key raw material requirement, i.e. timber, is met through imports from New Zealand. This exposes the company to the risks associated with timber availability and adverse changes/restrictions in timber export policies by the Government of the timber-supplying countries.

Vulnerability of profitability to adverse fluctuation in foreign currency exchange rate – Import constitutes a major part of VLPL’s total purchase and the entity does not have any formal hedging policy for its forex risk. Hence, it remains exposed to the risk of adverse movement in forex rates with respect to its import payables.

Liquidity position

VLPL’s fund flow from operations (FFO) turned positive to Rs. 0.31 crore in FY2018 compared to FY2017. Its free cash flows (before debt repayment) turned positive due to lower incremental working capital requirement. The company’s liquidity position is expected remain tight given two LC repayment in the near term and limited production because of shortage of labour leading to blocking of working capital. However, normalisation in availability of labour leading to an improvement in the conversion cycle of inventory to finished goods and the realisation of receivables are expected to support its liquidity.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology |
| Parent/Group Support | Not applicable |
| Consolidation / Standalone | The rating is based on standalone financial statements of issuer. |

About the company

Incorporated in 2002, VLPL processes and trades timber logs and manufactures wooden pallets. It deals in radiate pine logs, which are mainly imported from New Zealand and Singapore. The plant is located at Gandhidham in Gujarat, which is close to the Kandla port. The company is promoted by the Dubey family, the key promoters being Mr. Swami Nath Dubey and his son Mr. Jay Kumar Dubey. The promoters have more than 25 years of experience in the timber business.

In FY2018, VLPL reported a net profit of Rs. 0.40 crore on an operating income (OI) of Rs. 43.90 crore compared to a net profit of Rs. 0.26 crore on an OI of Rs. 36.72 crore in the previous year. Further, it achieved revenue of Rs. 37.8 crore in FY2019 on a provisional basis.

Key financial indicators (audited):

| | FY2017 | FY2018 |
|------------------------------|--------|--------|
| Operating Income (Rs. crore) | 36.72 | 43.90 |
| PAT (Rs. crore) | 0.26 | 0.40 |
| OPBDIT/ OI (%) | 3.05% | 4.71% |
| RoCE (%) | 15.95% | 16.60% |
| Total Debt/ TNW (times) | 2.70 | 2.26 |
| Total Debt/ OPBDIT (times) | 8.55 | 4.33 |
| Interest Coverage (times) | 1.30 | 1.39 |

Status of non-cooperation with previous CRA: None

Any other information: None

Rating history for last three years:

| Chronology of Rating History for the past 3 years | | | | | | | | | |
|---|------------|--------------------------|---|-------------------------|--|--|--------------------|--------------------------------------|-------------------------|
| Current Rating (FY2020) | | | | Date & Rating in FY2018 | | | | | |
| Instrument | Type | Amount Rated (Rs. crore) | Amount Outstanding as on March 31, 2019 (Rs. crore) | Date & Rating May 2019 | Date & Rating in FY2018 | | | Date & Rating in FY2017 January 2016 | Date & Rating in FY2017 |
| | | | | | January 2019 | December 2018 | June 2017 | | |
| Term Loan | Long Term | 2.00 | - | [ICRA]C | [ICRA]D; Removed from Issuer not Cooperating Category | [ICRA]B+ (Stable); ISSUER NOT COOPERATING | [ICRA]B+ (Stable); | [ICRA]B+ | - |
| Import Letter of Credit Cum Buyers Credit | Short Term | 20.00* | - | [ICRA]A4 | [ICRA]D; Removed from Issuer not Cooperating Category | [ICRA]A4; ISSUER NOT COOPERATING | [ICRA]A4; | [ICRA]A4 | - |

* Includes sublimit: BELC (Rs. 4.00 crore) and BG (Rs. 1.00 crore)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

| ISIN No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---------|---|-----------------------------|-------------|---------------|--------------------------|----------------------------|
| NA | Cash Credit | NA | NA | NA | 2.00 | [ICRA]C |
| NA | Import Letter of Credit cum Buyers Credit | NA | NA | NA | 20.00 | [ICRA]A4 |

Source: Variety Lumbers Private Limited

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