

June 24, 2019

Variety Lumbers Private Limited: Long-term rating upgraded to [ICRA]B-(Stable); short-term rating reaffirmed

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]B-(Stable); Upgraded from [ICRA]C
Non-fund based Import Letter of Credit cum Buyers Credit	20.00 [^]	20.00	[ICRA]A4; Reaffirmed
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 revision in the ratings takes into account the regular debt servicing in the past five months, following the improvement in the working capital cycle. Additionally, the churning up of inventory to sales with easing up of labour shortage issues and realisation of receivables leading to some easing up of liquidity position in recent months. The ratings continue to favourably factor in the extensive experience of Variety Lumbers Private Limited's (VLPL) promoters in the timber industry and the location-specific advantages due to the company's proximity to the Kandla port in Gujarat.

The ratings, however, are 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 (31% as on FY2019-end). ICRA notes that the inventory days increased to 97 in FY2019 from 58 in FY2018-end because of temporary labour shortage; however, the problem is expected to be resolved 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 because of substantial imports.

Outlook: Stable

ICRA expects VLPL to continue to benefit from the extensive experience of its promoters in the timber business and the strategic location of its facilities. The outlook may be revised to Positive if substantial growth in revenue and profitability leads to higher-than-expected cash accruals, which along with prudent working capital management improve the liquidity and the overall financial risk profile. The outlook may be revised to Negative if substantial reduction in scale and profitability leads to inadequate cash accruals or any stretch in the working capital cycle weakens the company's liquidity position and impacts its debt repayments capabilities.

Key rating drivers

Credit strengths

Extensive experience of promoters in 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, as a major part of its procurement is through imports, the company’s proximity to the Kandla port in Gujarat provides logistical advantage.

Regular debt servicing and improvement in working capital cycle – The company has been regularly repaying his debts to its lenders since the last five months (i.e. January 2019 – May 2019). Further, with churning up of inventory to sales with easing up of labour shortage issues and realisation of stuck receivables in recent months there has been some easing up of 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; the gearing was 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 spiked substantially in FY2019—the NWC/OI was 31% as on FY2019-end compared to 20% as on FY2018-end—due to an increase in inventory holding to 97 days in FY2019 from 58 days in FY2018. The inventory increased as labour shortage lowered production, leading to pile up of raw material inventory. However, by May 2019, the labour shortage problem was addressed, which released the stuck raw material inventory and consequently improved the liquidity position.

Intense competition due to presence of numerous players – The company’s margins are low as timber sawing and trading is a low value-added business. Additionally, stiff competition from numerous players operating in the fragmented industry keeps the company’s margins under check.

Exposure to government regulations of importing country; volatility in timber prices – A significant share of VLPL’s key raw material requirement, i.e. timber, is imported 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, its import payables remain exposed to adverse movements in forex rates.

Liquidity position

VLPL’s fund flow from operations (FFO) turned positive to Rs. 0.31 crore in FY2018, compared to FY2017. Additionally, its free cash flows (before debt repayment) turned positive due to lower incremental working capital requirement. The company’s liquidity position is expected to remain tight, given the LC repayment in the near term. However, normalisation of labour situation has improved the conversion cycle of inventory to finished goods and increased the realisation of receivables, which are expected to support the liquidity. The liquidity will be further supported by cushion available in terms of undrawn working capital limits.

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:

Current Rating (FY2020)				Chronology of Rating History for the past 3 years					
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2019 (Rs. crore)	Date & Rating in FY2019			Date & Rating in FY2018		Date & Rating in FY2017
				June 2019	May 2019	January 2019	December 2018	June 2017	
Cash Credit	Long Term	2.00	-	[ICRA]B- (Stable)	[ICRA]C	[ICRA]D; Removed from Issue not Cooperating Category	[ICRA]B+ (Stable); ISSUER NOT COOPERATING	[ICRA]B+ (Stable)	-
Import Letter of Credit Cum Buyers Credit	Short Term	20.00*	-	[ICRA]A4	[ICRA]A4	[ICRA]D; Removed from Issue not Cooperating Category	[ICRA]A4; ISSUER NOT COOPERATING	[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]B-(Stable)
NA	Import Letter of Credit cum Buyers Credit	NA	NA	NA	20.00	[ICRA]A4

Source: Variety Lumbers Private Limited

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