Setco Automotive Limited

March 20, 2017

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities – Term Loan	109.18 (Reduced from 135.08)	**CARE BBB; Negative (Triple B; Outlook: Negative)**	Reaffirmed
Long-term Bank Facilities – Fund-based –CC	174.00	**CARE BBB; Negative (Triple B; Outlook: Negative)**	Reaffirmed
Short-term Bank Facilities – LC/BG	2.00	**CARE A3 (A Three)**	Reaffirmed
Total	**285.18 (Rupees Two Hundred and Eighty Five Crore and Eighteen Lakhs only)**		

Details of facilities/instruments in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings continue to derive comfort from the established track record of Setco Automotive Limited (SAL) in clutch manufacturing for MHCVs, its long-standing relationship with Tata Motors Limited, approved Tier -1 supplier to various domestic and International Original Equipment Manufacturers (OEMs) and sales through diversified market channels reducing revenue concentration risk.

However, the rating strengths continue to be tempered by SAL's moderate sub-sectoral diversification, significant exposure to subsidiaries and related entities, moderate debt coverage indicators and inherent cyclicality associated with the auto industry.

The ability of SAL to improve operating margins through synergies to be derived from the backward integration and reduction in the exposure to subsidiaries/affiliates shall remain the key rating sensitivities.

Outlook: Negative

CARE notes that SAL was in capex mode for the past few years which mainly incudes the backward integration casting project under its subsidiary Lava Cast Private Limited. These projects have resulted into significant increase in group debt while subdued industry scenario is expected to delay the generation of envisaged benefits/cashflow from the projects. Furthermore, the group has undertaken a project in S E Transstadia Pvt Ltd and promoters shares have been pledged its holding against the loan availed for the project which reduces the future financial flexibility of the group. The outlook will be revised to stable if no further debt is availed, there is ramp-up of the facilities commissioned and if the company receives the funds invested in group companies. SAL has received Rs.8 crore on redemption of Preference Shares of Setco Engineering Pvt Ltd (total amount invested Rs.42.65 crore as on March 31, 2016) and is expected to received another Rs.12 crore by the end of March 2017.

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

Detailed description of the key rating drivers

Key Rating Strengths

Established track record and experienced promoter: SAL was jointly promoted by ‘Sheth Family’ and Government of Gujarat who divested their stake in the year 2001. SAL the flagship company of the ‘Sheth Group’ is led by Mr Harish Sheth.

Sales through diversified market channels reduces concentration risk: SAL has long standing relationship with OEM’s and act as supplier to leading supplier of clutches to commercial vehicle manufacturers in India. Its clientele includes, Ashok Leyland, AMW, Daimler India Commercial Vehicles, Tata Motors, Volvo- Eicher Commercial Vehicles.. Sales to OEM’s grew by 25.35% y-o-y to Rs.178 crore and contributed around 35% to the revenue for FY16. Replacement market demand contributed about 60% to total revenue for FY16 and grew by 6% y-o-y to Rs.300 crore.
In addition to presence in OES and IAM market SAL exports LIPE clutches to North America, Europe and Asia Pacific region. In FY16 export sales contributed about 4.7% to revenue for FY16 as against 7% in FY15 due to low demand.

Backward Integration Aimed at Improving Operating Margins: In April, 2015 SAL completed the development of in-house capability for manufacturing of diaphragm springs at a cost of about Rs.20 crore. The facility aims to provide SAL with stable supply of diaphragm springs and cost reduction thereby improving profitability margins going forward. The facility has started operations in Q1FY16.
SAL has entered into JV with Lingotes Especiales (LE) of Spain for setting up of Ferrous Foundry through its subsidiary, Lava Cast Pvt Ltd (LCPL) with SAL contributing 80% equity and LE contributing remaining 20%. The foundry has a capacity of about 30,000 tons per annum and has been setup at a cost of about Rs.183 crore. The foundry facility has begun commercial operations from April 2016. Currently, the facility is manufacturing 1,000 tonnes of casting p.m which is used by SAL. The facility is in its first year of operation and would require two years to stabilize operations.

Stable Operational Performance in FY16, however moderated in 9MFY17: Income from Operations grew by 10.45% y-o-y to Rs.523 crore in FY16. Overall CV segment registered a 12.6% growth in FY16. PBILDT margin improved to 16.54% in FY16 from 13.62% in FY15 with increased sales in aftermarket and low commodity prices.

During 9MFY17 on standalone basis the company recored total income of Rs.342.33 crore and PAT of Rs.7.95 crore as compared to total income of Rs.342.29 crore and PAT of Rs.17.05 crore. Demonitisation has adeversely affected the demand in the replacement market which is temporarily expected to impact the performance of SAL.

Key Rating Weaknesses

Moderate Sub Sectorial diversification: The auto component industry is impacted by the cyclical nature of the automobile industry. The diversification of auto component players across different segments like passenger vehicles, commercial vehicles, 2/3 wheeler, farm helps to overcome the impact of cyclical nature of the industry. SAL has its major share of revenue from the MHCV segment. This exposes SAL to segment concentration.

Increased exposure to subsidiaries and related entities: The exposure towards its subsidiaries/affiliates/holding, related entities in the form of investments is Rs.111.21 crore (PY: Rs.81.97 crore), loans and advances Rs.52.98 crore (PY: Rs.45.45 crore) and unconditional and irrevocable corporate guarantees Rs.223.38 crore (PY: Rs.159.33 crore) as on March 31, 2016. During FY15 and FY16, SAL has given corporate guarantee for the credit facilities availed by Lava Cast Pvt ltd.

Leveraged Capital Structure and moderate liquidity profile: Overall gearing deteriorated to 2.53x as on March 31, 2016 from 2.29x as on March 31, 2015 with debt availed in SAL and guarantee provided for debt of LCPL. On a consolidated basis, overall gearing deteriorated to 2.47x as on March 31, 2016 from 2.11x as on March 31, 2015. The company has a moderate liquidity profile with long operating cycle of around 4 months mainly due to the finished goods inventory to be maintained. The stretched working capital cycle led to limited cushion in working capital bank lines, which were utilised at an average of 90-95% during the past 12 months ending December 2016.

Analytical approach: Consolidated view on Setco Automotive Limited and all its subsidiaries has been taken for arriving at the ratings as the entities are under a common management, have similar line of business and financial linkages. Furthermore, SAL has provided corporate gurantee to the Bank facilities availed by two of its subsidiaries Setco Automotive UK Limited (SAUL) and Lava Cast Private Limited (LCPL).

Applicable Criteria:

Criteria on assigning outlook to credit ratings
CARE's policy on default recognition
Criteria for short-term instruments
Financial Ratios: Non Financial Sectors
Rating methodology: Manufacturing companies

About the Company

Setco Automotive Limited (SAL) is engaged in manufacture of clutches for Medium and Heavy Commercial vehicles (MHCV) and markets it under brand name 'LIPE Clutches'. SAL led by Mr Harish Sheth, is the flagship company of the 'Sheth Group'. Incorporated in 1982, SAL has 5 manufacturing facilities 3 in India (Kalol, Alindra -Gujarat, Sitarganj - Uttarakhand,), 1 in United Kingdom (Haslingden - Lancashire) and 1 in USA (Paris – Tennessee) as on March 31, 2016. The overseas facilities of SAL act as assembling units. At present, SAL meets about 85% of MHCV Original Equipment (OEM) demand in India. The product line of SAL also includes supply of hydraulics (pressure converters) and fully machined ferrous castings.

During FY16, on a consolidated basis (refers to the period April 01 to March 31), the company reported a PAT of Rs.22.90 crore (PY: Rs.20.61 crore) on a total operating income of Rs.569.76 crore (PY: 527.84 crore). Furthermore during 9MFY17, SAL on a standalone basis reported net profit of Rs.7.95 crore on a total income of Rs.342.33 crore.

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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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 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
Fund-based - LT-Cash Credit	-	-	-	174.00	CARE BBB; Negative
Fund-based - LT-Term Loan	-	-	Quarterly installments upto FY23	109.18	CARE BBB; Negative
Non-fund-based - ST-BG/LC	-	-	-	2.00	CARE A3

Annexure 2

Rating History for 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 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015	Date(s) & Rating(s) assigned in 2013-2014
1.	Fund-based - LT-Term Loan	LT	109.18	CARE BBB; Negative	-	1)CARE BBB (10-Mar-16) 2)CARE BBB (08-Feb-16)	1)CARE BBB (22-Jan-15)	1)CARE BBB (18-Feb-14)
2.	Fund-based - LT-Cash Credit	LT	174.00	CARE BBB; Negative	-	1)CARE BBB (10-Mar-16) 2)CARE BBB (08-Feb-16)	1)CARE BBB (22-Jan-15)	1)CARE BBB (18-Feb-14)
3.	Non-fund-based - ST-BG/LC	ST	2.00	CARE A3	-	1)CARE A3 (10-Mar-16) 2)CARE A3 (08-Feb-16)	1)CARE A3 (22-Jan-15)	1)CARE A3 (18-Feb-14)

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