

## Setco Automotive Limited

June 10, 2019

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long term Bank Facilities	257.18	CARE BBB-; Stable (Triple B minus; Outlook: Stable)	Revised from CARE BBB-; Positive (Triple B minus; Outlook: Positive)
Short term Bank Facilities	2.00	CARE A3	Reaffirmed
<b>Total</b>	<b>259.18</b> <b>(Rupees Two hundred and fifty nine crore eighteen lakh only)</b>		

*Details of instruments/facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Setco Automotive Limited (SAL) continue to derive strength from its established track record in clutch manufacturing for Medium and Heavy Commercial Vehicles (MHCV's), its long-standing relationship with various domestic and global Original Equipment Manufacturers (OEMs) and sales through diversified market channels reducing revenue concentration risk and shifting focus towards the after-market segment which is less prone to cyclical.

However, the rating strengths continue to be tempered by loss making subsidiaries which continue to deplete the consolidated net-worth, highly leveraged capital structure with moderate debt coverage indicators and high working capital intensity (inherent to its business) adversely impacting the liquidity indicators.

Successful turnaround of its subsidiaries whereby they start positively contributing to consolidated operating profit margins and thereby improving the consolidated debt coverage indicators would be key rating sensitivities.

#### Outlook: Revised from Positive to Stable

The revision in outlook assigned to SAL from 'Positive' to 'Stable' factors in the recent moderation witnessed in the demand outlook for domestic and global automobile industry (including both commercial vehicles and passenger vehicles) which is expected to impact the Total Operating Income for FY20. Further, the subsidiaries (some of them) continue to post loss which impacted the consolidated performance as against the envisaged.

### Detailed description of the key rating drivers

#### Key Rating Strengths

#### **Established track record and experienced promoters**

SAL was jointly promoted by 'Sheth Family' and Government of Gujarat which divested its stake in the year 2001. SAL, the flagship company of the 'Sheth Group' is led by Mr. Harish Sheth. At present, SAL caters about 85% of MHCV Original Equipment (OEM) demand in India and it is an exclusive supplier to Tata Motors Limited's CV and MHCV segments.

#### **Established relationship with OEMs**

SAL has long standing relationship with OEMs and acts as supplier to leading supplier of clutches to commercial vehicle manufacturers in India. Its clientele includes Tata Motors, Ashok Leyland, AMW, Daimler India Commercial Vehicles, Volvo-Eicher Commercial Vehicles, Mahindra & Mahindra and MAN India. Sales to OEMs contributed around 43% to the revenue for FY19.

#### **Improved operating performance in FY19; however loss making subsidiaries continue to be a drag on consolidated financials**

The financial performance of SAL improved during FY19 as reflected by growth in Total Operating Income (TOI) by 14% and improvement in operating margins by 119 basis points. The top-line growth was driven by 35% growth in the after-market segment during FY19. SAL recorded highest ever operating margin in FY19 on account of higher pricing, increased volumes and better segment mix. The loss-making subsidiaries are however taking longer than expected duration for turn-around.

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and in other CARE publications.

### Key Rating Weaknesses

#### **Leveraged Capital Structure and moderate debt coverage indicators**

SAL has been undertaking the debt funded capex for the past few years which mainly includes the backward integration casting project under its subsidiary LCPL. This has adversely impacted the overall gearing which remained elevated at 2.49x as on March, 31 2019 (on a consolidated basis). Further, the overall gearing deteriorated marginally due to depletion in the net-worth on account of loss-making subsidiaries. Interest coverage indicators however showed an improvement in FY19 due to better operating performance.

#### **Exposed to cyclical nature associated with the auto industry**

The auto component industry is impacted by the cyclical nature of the automobile industry. SAL has its major share of revenue from MHCV segment which exposes it to segment concentration risk. However the presence of SAL in replacement market and export market helps to partially offset the segment concentration risk as it has been observed that the demand in replacement market picks-up when there is drop in sale of new vehicles. The replacement market demand contributed about 57% to total revenue for FY19. SAL also has entered in the farm tractor and LCV segments which are also expected to further reduce the concentration risk.

#### **Liquidity analysis**

The liquidity position of SAL is moderate as reflected by cash and cash equivalents of Rs.12.36 crore as on March 31, 2019. Further, the unutilized fund based bank lines as on March 31, 2019 stood at Rs.32 crore. SAL has long operating cycle of around 4 months mainly due to the finished goods inventory to be maintained. However, operating cycle has shown a marginal improvement in FY19 due to better collection cycle.

#### **Analytical approach:**

CARE has taken a consolidated view on Setco Automotive Limited and all its subsidiaries for arriving at the ratings as the entities are under a common management, have similar line of business and financial linkages. List of subsidiaries which are consolidated is presented in Annexure 3. Further SAL has provided corporate guarantee to the facilities availed by its subsidiary LCPL.

#### **Applicable Criteria**

[Criteria on assigning Outlook to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Rating methodology: Manufacturing companies](#)

[Rating Methodology: Factoring Linkages in Ratings](#)

[Criteria for Short Term Instruments](#)

[Financial ratios – Non-Financial Sector](#)

#### **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 manufacturing facilities in India (Kalol in Gujarat, Sitarganj in Uttarakhand), United Kingdom (Haslingden - Lancashire) and USA (Paris – Tennessee). 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.

Brief Consolidated Financials (Rs. crore)	FY18 (A)	FY19 (A)*
Total operating income	602.15	686.27
PBILDT	83.09	102.89
PAT	(0.96)	(0.53)
Overall gearing (times)	2.23	2.49
PBIT Interest coverage (times)	1.65	1.96

A: Audited

\*Limited review

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

**Any other information: Not applicable**

Rating History for 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
Fund-based - LT-Term Loan	-	-	Q4 FY21	73.18	CARE BBB-; Stable
Fund-based - LT-Cash Credit	-	-	-	184.00	CARE BBB-; Stable
Non-fund-based - ST-BG/LC	-	-	-	2.00	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.	Fund-based - LT-Term Loan	LT	73.18	CARE BBB-; Stable	-	1)CARE BBB-; Positive (17-Sep-18)	1)CARE BBB-; Stable (18-Oct-17) 2)CARE BBB-; Stable (22-Sep-17)	1)CARE BBB; Negative (20-Mar-17)
2.	Fund-based - LT-Cash Credit	LT	184.00	CARE BBB-; Stable	-	1)CARE BBB-; Positive (17-Sep-18)	1)CARE BBB-; Stable (18-Oct-17) 2)CARE BBB-; Stable (22-Sep-17)	1)CARE BBB; Negative (20-Mar-17)
3.	Non-fund-based - ST-BG/LC	ST	2.00	CARE A3	-	1)CARE A3 (17-Sep-18)	1)CARE A3 (18-Oct-17) 2)CARE A3 (22-Sep-17)	1)CARE A3 (20-Mar-17)

**Annexure-3: List of subsidiaries which are consolidated**

Sr. No.	Name of the company
1.	Lava Cast Private Limited
2.	Setco Auto (UK) Limited
3.	Setco Auto (NA) Inc
4.	WEW Holdings Limited
5.	Setco MEA DMCC

**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](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.

## Contact us

### Media Contact

Mradul Mishra  
Contact no. – +91-22-6837 4424  
Email ID – [mradul.mishra@careratings.com](mailto:mradul.mishra@careratings.com)

### Analyst Contact

Name: Mr. Kunal B Shah  
Contact no.- 022 6754 3451  
Email ID- [kunalb.shah@careratings.com](mailto:kunalb.shah@careratings.com)

### Business Development Contact

Name: Kunal Shah  
Contact no. : 022 6754 3468  
Email ID: [kunal.shah@careratings.com](mailto:kunal.shah@careratings.com)

### About CARE Ratings:

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In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

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