

Setco Automotive Limited

August 12, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating ¹	Rating Action
Long term Bank Facilities	257.18	CARE BB; Negative (Double B; Outlook: Negative)	Revised from CARE BBB-; Stable (Triple B Minus; Outlook: Stable)
Short term Bank Facilities	2.00	CARE A4 (A Four)	Revised from CARE A3 (A Three)
Total	259.18 (Rupees Two hundred and fifty nine crore eighteen lakh only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings of Setco Automotive Limited (SAL) factors in the weakened liquidity on back of slowdown witnessed in automotive segment. SAL is extending higher credit period to its customers, which are largely Original Equipment's Manufacturers (OEM's), similar expansions in credit period is not available to it from its suppliers, as most of its suppliers are SME's (Small and Medium enterprises). Liquidity weakness is further aggravated due to high utilization on its working capital lines, which translates into minimal cushion to manage weak demand scenario. The revision also factors in the weaker than envisaged leverage and debt coverage indicators reported for FY19.

The ratings continue to be tempered by loss-making subsidiaries which are depleting the consolidated net-worth, customer concentration risk as significant part of its revenue is contributed by top two customers under sales to OEM segment, its elevated leverage (as on March 31, 2019) and high working capital intensity on account of long operating cycle.

The aforesaid constraints are, however, partially offset by experience of promoters in automotive business, favorable revenue mix both from OEM's and replacement market and long standing relationship with domestic and global OEM's.

Outlook: Revised to Negative

The revision in outlook assigned to SAL from 'Stable' to 'Negative' factors in the significant weakness witnessed in the demand outlook for domestic (including both commercial vehicles and passenger vehicles), which would translate into elongation in payment terms from its customers and liquidity challenges arising due to same. Further, owing to depleting demand from OEM's the Total Operating Income for FY20 is expected to remain subdued. The debt coverage indicators are expected to weaken further given high debt dependency coupled with moderation in expected cash accruals for FY20.

Detailed description of the key rating drivers

Key Rating Weaknesses

Leveraged Capital Structure with weakened liquidity indicators:

SAL has been undertaking 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 2.83x 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. The liquidity indicators have also weakened on account of slowdown in the auto industry which has led to delay in realization from OEM's thereby resulting into higher working capital utilization and limiting company's financial flexibility.

Exposed to cyclical nature associated with the auto industry:

The auto component industry is impacted by the cyclical nature of the automobile industry. The auto industry is currently facing slowdown due to weak demand scenario impacting volumes of OEM's. However, the demand in the replacement market is an indirect function of demand from OEMs. The presence of SAL in replacement market partially offsets the weak demand from OEMs.

Higher segment and customer concentration risk:

SAL has its major share of revenue from MHCV segment which exposes it to segment concentration risk. Further, around 70% of the total revenue from OEM's is derived from top two OEM's. Any change in business risk profile of these companies is likely to have a material impact on the business of SAL.

Key Rating Strengths

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

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 16.4% and an improvement in operating margins. The top-line growth was driven by 35% growth in the after-market segment during FY19. Operating margin expansion was driven by higher pricing, increased volumes and better segment mix. The loss-making subsidiaries are however taking longer than expected duration for turn-around and are depleting the consolidated net-worth of SAL.

Liquidity position:

The liquidity position of SAL is weak as reflected by high working capital utilization at the end of July 2019 coupled with elongated credit period extended to its customers which translates into minimal cushion to manage weak demand scenario.

Analytical approach: Consolidated

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	588.61	685.30
PBILDT	76.17	101.91
PAT	(0.96)	(0.54)
Overall gearing (times)	2.52	2.83
Interest coverage (times)	1.51	1.94

A: Audited

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 BB; Negative
Fund-based - LT-Cash Credit	-	-	-	184.00	CARE BB; Negative
Non-fund-based - ST-BG/LC	-	-	-	2.00	CARE A4

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 BB; Negative	1)CARE BBB-; Stable (10-Jun-19)	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 BB; Negative	1)CARE BBB-; Stable (10-Jun-19)	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 A4	1)CARE A3 (10-Jun-19)	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	Percentage holding of SAL
1.	Lava Cast Private Limited	87.24%
2.	Setco Auto (UK) Limited	100%*
3.	Setco Auto (NA) Inc	100%
4.	WEW Holdings Limited	100%
5.	Setco MEA DMCC	100%

*The share capital of Setco Automotive (UK) Ltd is held 20% by Setco Automotive Limited and 80% by WEW Holding Limited.

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.

Contact us

Media Contact

Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact 1

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

Analyst Contact 2

Name: Mr. Milind Gadkari
Contact no.- 022 6754 3466
Email ID- milind.gadkari@careratings.com

Business Development Contact

Name: Kunal Shah
Contact no. : 022 6754 3468
Email ID: kunal.shah@careratings.com

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.

Disclaimer

CARE's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CARE has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable. CARE does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

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.

Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**