

## Setco Automotive Limited

September 17, 2018

### Ratings

| Facilities                                 | Amount<br>(Rs. crore)   | Rating <sup>1</sup>   | Rating Action   |
|--|---|---|---|
| Long term Bank Facilities<br>– Term loan   | 73.18   | CARE BBB-; Positive<br>(Triple B minus; Outlook:<br>Positive) | Revised from CARE BBB-;<br>Stable<br>(Triple B minus; Outlook:<br>Stable) |
| Long-term Bank Facilities<br>– Cash Credit | 184.00  | CARE BBB-; Positive<br>(Triple B minus; Outlook:<br>Positive) | Revised from CARE BBB-;<br>Stable<br>(Triple B minus; Outlook:<br>Stable) |
| Short term Bank Facilities                 | 2.00  | CARE A3   | Reaffirmed  |
| <b>Total</b>                               | <b>259.18</b><br><b>(Rs. Two hundred and fifty<br/>nine crore eighteen lakh<br/>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 established track record of SAL in clutch manufacturing for Medium and Heavy Commercial Vehicles (MHCVs), its long-standing relationship with 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 working capital intensive nature of operations leading to moderate liquidity position, leveraged capital structure and moderate debt service coverage indicators and inherent cyclicity associated with the auto industry.

The ability of SAL to scale up its operations, improve its profitability margins and cash accruals on consolidated basis and to successfully ensure turnaround of its subsidiaries shall remain the key rating sensitivities.

#### Outlook: Positive

The business and financial risk profile of Setco group is expected to improve over medium term supported by healthy cash accruals of SAL backed by robust performance of the Commercial Vehicle sector. Further the performance of the loss making subsidiaries which earlier was a drag on the consolidated performance of the group has also started improving with the ramp up of operations of Lava Cast Private Limited (LCPL). Thus the subsidiaries would require less support from the parent SAL in turn improving the financial risk profile of the group. The outlook will be revised to stable if the sales and profitability moderates or any large debt-funded capex weakens the financial risk profile.

### 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. 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 45% to the revenue for FY18 (refers to the period of April 01 to March 31).

##### **Improved operating performance and is expected to improve further in medium term**

The performance of SAL was impacted during FY17 and Q1FY18 (refers to the period of April 01 to June 30) by demonetization and then continued uncertainty on sale & registration of BS III vehicles beyond March 31, 2017. The introduction of GST further impacted Q1FY18 revenues. The industry recovered from Q2FY18 onwards and the company

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

has recorded revenues of Rs.550.54cr (PY Rs.523.35cr) and operating margin of 15.59% (13.95%) on standalone basis for FY18. During Q1FY19 the company has posted PBILDT of Rs. 25.1 crore and PAT of Rs. 8.18 crore.

Further the performance of the loss making subsidiaries have started improving. LCPL which has posted cash loss of Rs.12.49 crore during FY18 has posted cash profit of Rs. 1.13 crore during Q1FY19. The performance of LCPL has stabilized and is now getting orders from TATA motors, Ashok Leyland. The performance of the UK and US subsidiary has also improved. Thus the consolidated performance is expected to improve in medium term.

### **Key Rating Weaknesses**

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

SAL was in capex mode for the past few years which mainly includes the backward integration casting project under its subsidiary LCPL. The backward integration would provide SAL with steady supply of quality raw materials and cost savings. The debt funded expansion plans of SAL has impacted its capital structure over the years.

On a consolidated basis, overall gearing improved marginally to 2.52x as on March 31, 2018 from 2.58x as on March 31, 2017 with debt repayments in subsidiaries. The group has significant repayment obligations in the next couple of years leading to moderate debt service coverage indicators.

#### **Working capital intensive nature of operations leading to moderate liquidity profile**

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 utilized at an average of 95% for 12 months ended July 2018.

#### **Exposed to cyclicity 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. This exposes SAL 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 50% to total revenue for FY18. SAL also has entered in the farm tractor and LCV segments which are also expected to further reduce the concentration risk.

**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. 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) as on July 31, 2018. 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.

| <b>Brief Consolidated Financials (Rs. crore)</b> | <b>FY17 (A)</b> | <b>FY18 (A)</b> |
|--|-----------------|-----------------|
| Total operating income                           | 569.81          | 590.24          |
| PBILDT   | 60.13           | 76.17           |
| PAT  | -13.60          | -0.96           |
| Overall gearing (times)                          | 2.58            | 2.52            |
| PBIT Interest coverage (times)                   | 0.57            | 0.85            |

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

**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.

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**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   | -                | -           | Q4FY21        | 73.18                         | CARE BBB-;<br>Positive                    |
| Fund-based - LT-Cash Credit | -                | -           | -             | 184.00                        | CARE BBB-;<br>Positive                    |
| 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 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018                          | Date(s) & Rating(s) assigned in 2016-2017 | Date(s) & Rating(s) assigned in 2015-2016        |
| 1.      | Fund-based - LT-Term Loan              | LT              | 73.18                          | CARE BBB-; Positive | -   | 1)CARE BBB-; Stable (18-Oct-17)<br>2)CARE BBB-; Stable (22-Sep-17) | 1)CARE BBB; Negative (20-Mar-17)          | 1)CARE BBB (10-Mar-16)<br>2)CARE BBB (08-Feb-16) |
| 2.      | Fund-based - LT-Cash Credit            | LT              | 184.00                         | CARE BBB-; Positive | -   | 1)CARE BBB-; Stable (18-Oct-17)<br>2)CARE BBB-; Stable (22-Sep-17) | 1)CARE BBB; Negative (20-Mar-17)          | 1)CARE BBB (10-Mar-16)<br>2)CARE BBB (08-Feb-16) |
| 3.      | Non-fund-based - ST-BG/LC              | ST              | 2.00                           | CARE A3             | -   | 1)CARE A3 (18-Oct-17)<br>2)CARE A3 (22-Sep-17)                     | 1)CARE A3 (20-Mar-17)                     | 1)CARE A3 (10-Mar-16)<br>2)CARE A3 (08-Feb-16)   |

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