

Setco Automotive Limited

November 25, 2019

Ratings

| Facilities | Amount (Rs. crore) | Rating ¹ | Rating Action |
|----------------------------|--|---|---|
| Long term Bank Facilities | 257.18 | CARE B; Negative (Single B; Outlook: Negative) | Revised from CARE BB; Negative (Double B; Outlook: Negative) |
| Short term Bank Facilities | 2.00 | CARE A4 (A Four) | Reaffirmed |
| 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 assigned to the bank facilities of Setco Automotive Limited (SAL) factors in continuing losses reported by SAL at the consolidated level on the back of weak demand scenario witnessed in the automotive segment [especially Medium & Heavy Commercial Vehicle (MHCV) segment], weakened liquidity, 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 H1FY20.

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 September 30, 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.

Rating Sensitivities

Positive Factors

- Substantial equity infusion translating into comfortable leverage and liquidity indicators
- Positive profitability at the consolidated level on a consistent basis and turnaround of all loss-making subsidiaries
- Improvement in overall gearing to 1.5x at the consolidated level on a sustained basis

Negative Factors

- Continuing losses at the consolidated level
- Further deterioration in liquidity and leverage indicators

Outlook: Negative

The negative outlook assigned to SAL 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 and liquidity 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

Deteriorating operating performance in H1FY20; loss making subsidiaries continue to be a drag on consolidated financials:

On a standalone basis, SAL reported 30% decline in top-line in H1FY20 due to weak demand scenario witnessed by the automotive segment (especially MHCV segment) translating into lower Profit After Tax (PAT) in H1FY20 which declined by 33.1% on a YoY basis. Further, the loss-making subsidiaries are taking longer than expected duration for turn-around and are depleting the consolidated net-worth of SAL.

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 as on H1FY20 (on a consolidated basis). The overall gearing deteriorated further in H1FY20 due to depletion in the net-worth on account of loss-making subsidiaries. The liquidity indicators have also weakened as reflected by higher working capital utilization limiting company's financial flexibility.

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

Exposed to cyclicity 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
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 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.

Liquidity: Poor

The liquidity position of SAL is poor as reflected cash and cash equivalents of Rs.8.95 crore at the end of September 30, 2019 and high working capital utilization coupled with elongated credit period extended to its customers which translates into minimal cushion to manage weak demand scenario.

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 4. Further SAL has provided corporate guarantee to the facilities availed by its subsidiary LCPL.

Applicable Criteria

[Criteria on assigning 'outlook' and 'credit watch'](#)

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

[Rating Methodology - Manufacturing Companies](#)

[Rating Methodology - Auto Ancillary Companies](#)

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

[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.

Covenants of rated instrument / facility: Not available

| Brief Financials (Rs. crore) | FY18 (A) | FY19 (A) | H1FY20 (UA) |
|------------------------------|----------|----------|-------------|
| Total operating income | 588.61 | 685.30 | 272.95 |
| PBILDT | 76.17 | 101.91 | 36.84 |
| PAT | (0.96) | (0.54) | -11.03 |
| Overall gearing (times) | 2.52 | 2.83 | * |
| Interest coverage (times) | 1.51 | 1.94 | 1.48 |

A: Audited

*Cannot be determined as exact debt details are not available

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 | ISIN | 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 B; Negative |
| Fund-based - LT-Cash Credit | - | - | - | - | 184.00 | CARE B; 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 B; Negative | 1)CARE BB; Negative (12-Aug-19) 2)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 B; Negative | 1)CARE BB; Negative (12-Aug-19) 2)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 A4 (12-Aug-19) 2)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: Detailed explanation of covenants of the rated instrument / facilities: Not available

Annexure 4: 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.

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