June 02, 2021

Setco Automotive Limited: [ICRA]D assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Bonds/NCD/LTD	350.0	[ICRA]D; Assigned
Total	**350.0**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the ratings, ICRA has taken a consolidated view of Setco Automotive Limited (SAL), and its subsidiaries, given the close business, financial and managerial linkages among them.

The assigned rating considers SAL's ongoing irregularities in servicing of its bank debt obligations on account of weak liquidity position arising from its stretched financial profile. This was on the back of the downturn faced by the medium & heavy commercial vehicles (M&HCV) industry in the last two years, which was further exacerbated by the Covid-19 pandemic. Besides, internal challenges in scaling up of Lava Cast Private Limited (LCPL), a subsidiary of SAL, resulted in high cash burn at the consolidated level and affected the liquidity profile at the Group level. The rating also factors in the modest debt coverage indicators and high working capital intensive nature of business, given the stretched debtor position and high inventory levels. The rating, however, takes into account the extensive experience of the promoters, established operational track record and strong relationships with original equipment manufacturers (OEM) in the M&HCV clutch manufacturing business.

ICRA notes that the company has proposed a restructuring of its business, wherein it proposes to repay all its bank obligations by raising fresh debt from an external investor. Post that, the plan covers transfer of its sole (clutch) manufacturing business on a slump sale basis to Setco Auto Systems Private Limited (SASPL, erstwhile TransStadia Sport Sciences Private Limited), a wholly-owned subsidiary[1] of SAL. It has further plans to raise debt at the SASPL level to streamline the business, and re-energise the company through this liquidity support.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters and established operational track record of the company for more than 35 years in the auto component industry – SAL is managed by Mr. Harish Sheth, who have an extensive experience of over 35 years in the auto component industry. SAL manufactures clutches primarily for MHCVs and has an established operational track record. The company's revenues are distributed across three key segments, original equipment manufacturers (OEM), original equipment suppliers (OES) and independent aftermarket (IAM). The company forayed into the manufacturing of clutches for the farm tractor segment in FY2021. SAL also sells its products in foreign markets through its three foreign subsidiaries.

Strong relationships with OEMs with repeat businesses – The company has developed an established customer base with several repeat businesses. It has an established brand presence in the automotive market with reputed M&HCV OEMs in India.

[1] Subsidiary from Q4 FY2021

Credit challenges

Ongoing delays in servicing of debt obligations – SAL has been delaying its debt servicing from the last fiscal owing to the downturn faced by the automotive industry, which was further exacerbated by the Covid-19 pandemic, resulting in its poor liquidity position. Regularisation of debt servicing for a sustained period remains a key rating monitorable.

Weak financial profile characterised by net losses at the consolidated level for the last four years, high working capital intensity and modest debt coverage indicators – The financial profile of the company remained weak owing to net losses at the consolidated level for the last four years. The company reported losses of Rs. 13.6 crore in FY2017, which increased to Rs.49.6 crore in FY2020 owing to significant reduction in the top line of the company at the consolidated level. SAL's revenues at the consolidated level declined to Rs. 471.1 crore in FY2020 from Rs. 681.2 crore in FY2019 owing to industry-wide slowdown in the automotive sector and migration to BS-VI vehicles. The revenues further declined to Rs. 245 crore in 9M FY2021 owing to the Cvid-19 pandemic leading in lockdown and global supply chain issues. On a consolidated level, the company also reported losses due to internal challenges in LCPL, a subsidiary of SAL. The company's working capital intensity of operations have historically remained on the higher side in the range of 20-30% during FY2016 to FY2020 owing to elongated receivables and high inventory levels. The company's debt coverage indicators have historically remained modest, as reflected by an interest coverage of above 1.25 times and TOL/TNW of below 3.00 times during FY2016-FY2019. The debt coverage indicators further weakened in FY2020, as reflected by an interest coverage of 0.6 times, and TD/OPBDITA of 11.5 times as on March 31, 2020 owing to lower profit levels.

Stressed financial profile of LCPL, which has undergone debt restructuring in FY2021 – LCPL, an 89.2% subsidiary of SAL started commercial production from April 2016, wherein it has an installed casting capacity of 30,000 MTPA. LCPL has been reporting losses for the past four years due to internal challenges like higher rejections and lower yields. The downturn in the OEM production in the last two years further impacted the utilisation levels of the company. LCPL could not service the debt obligation in FY2020 due to high losses and internal challenges. The company underwent debt restructuring, which was implemented in FY2021, providing much needed liquidity buffer to LCPL through elongated repayment period along with lower interest cost. The same is also expected to reduce dependence on SAL going forward, however the actual scenario remains to be seen.

High exposure to cyclicality in the auto industry, wherein near-term challenges related to Covid-19 remains – SAL primarily caters to the automobile industry and manufactures clutches used in MHCVs. Thus, it remains exposed to the cyclicality in the auto industry as evident from the volatility in the top line over the past fiscals. Further, it is also exposed to near-term challenges related to the Covid-19 pandemic, affecting demand in the auto industry.

Liquidity position: Poor

The company's liquidity profile remained poor with negative cash accruals, resulting in delays in repayment of debt obligation. Further, it had minimal liquidity buffer in the form of undrawn working capital due to almost full average monthly utilisation levels of the fund-based working capital limits during the past 12-month period that ended on April 30, 2020. However, the company intends to improve its liquidity position and streamline its business through the upcoming restructuring plan.

Rating sensitivities

Positive factors – The rating may be upgraded in case of an improvement in the credit profile of the company, resulting in regularisation of debt servicing for a sustained period.

Negative factors – Not Applicable

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology](#) [Rating Methodology for Auto component suppliers](#) [Policy on Default Recognition](#)
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of SAL. As on December 31, 2020, the company had five subsidiaries, which are all enlisted in Annexure-2, given the close business, financial and managerial linkages among them.

About the company

Established in 1982 in collaboration with Gujarat Industrial Development Corporation (GIDC), Gujarat Setco Automotive Limited (GSAL) was a manufacturer of clutches for original equipment manufacturers (OEMs). Around 2000, GIDC stepped out of GSAL and it was renamed as Setco Automotive Limited (SAL). SAL is the flagship company of The Setco Group, promoted by the Sheth family and is involved in manufacturing of clutches primarily for MHCVs. The company sells clutches under its own brand name – LIPE. SAL is managed by Mr. Harish Sheth, who have an extensive experience of over 35 years in the auto component business. The company has its own manufacturing unit in Gujarat and another assembly unit in Uttarakhand. In addition to OEMs, the company caters to the original equipment suppliers (OES) and independent aftermarket (IAM). Further, SAL has forayed into manufacturing of clutches for the farm segment (tractors) in FY2021. At present, there are no operations in SASPL. However, after the slump sale, the entire clutch business will be transferred to SASPL from SAL.

Key financial indicators (Consolidated, Audited)

	FY2019	FY2020
Operating Income (Rs. crore)	681.2	471.1
PAT (Rs. crore)	-0.5	-49.6
OPBDIT/OI (%)	14.4%	7.7%
PAT/OI (%)	-0.1%	-10.5%
Total Outside Liabilities/Tangible Net Worth (times)	3.0	5.1
Total Debt/OPBDIT (times)	3.8	11.5
Interest Coverage (times)	1.9	0.6

Source: Company, ICRA research, All ratios as per ICRA calculations

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in June 2, 2021	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
						-	-	-
1	NCD	Long-term	350.0	-	[ICRA]D	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term - Bonds/NCD/LTD	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Proposed	NCD	NA	NA	NA	350.00	[ICRA]D

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership*	Consolidation Approach
Lava Cast Private Limited	89.19%	Full Consolidation
Setco Automotive (NA) Inc. (wholly owned subsidiary of Setco Automotive (UK) Limited)	100%	Full Consolidation
Setco Automotive (UK) Limited (67.81% is owned by WEW Holding Limited)	32.19%	Full Consolidation
WEW Holding Limited	100%	Full Consolidation
Setco MEA DMCC	100%	Full Consolidation

Source: *Company; *As on December 31, 2020*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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