May 21, 2024

Setco Auto Systems Private Limited: Rating reaffirmed; [ICRA]B- (Stable) assigned to Rs. 20-crore NCD programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term- Non-convertible Debenture	215.00	215.00	[ICRA]B-(Stable); reaffirmed
Long term- Non-convertible Debenture	350.00	350.00	[ICRA]B-(Stable); reaffirmed
Long term- Proposed Non-convertible Debenture	-	20.00	[ICRA]B-(Stable); assigned
Total	**565.00**	**585.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation considers Setco Auto Systems Private Limited's (SASPL) weak financial profile on account of net losses and modest debt coverage indicators as on March 31, 2024 (on a provisional basis). Further, the rating factors in the likelihood that SASPL's net profit as well as coverage indicators would continue to remain under pressure owing to its significant debt levels, coupled with accumulated interest, as the redemption is due in FY2026. The company's ability to timely redeem the bonds through a mix of refinancing, equity infusion or generation of internal accruals will be monitored for its credit profile. ICRA also notes that the Group's financial profile continues to be weak, given continuous delays in debt servicing by its associate concern, Lava Cast Pvt. Ltd. (LCPL) due to underutilisation of capacity. SASPL has provided support to LCPL for maintenance capex and business stabilisation through funds from non-convertible debentures (NCD), along with equity infusion in FY2022 and FY2023. ICRA notes that SASPL has further given Rs. 10 crore to LCPL in FY2024 from its own cash flows against the earlier understanding of not supporting LCPL from its own cash flows, post the last support extended in FY2023. ICRA, however, notes that the money was advanced on the pretext of Ind-RF extending a further loan of Rs. 20 crore to SASPL, which would reimburse the support extended to LCPL. Hence, it was largely a stop-gap arrangement. ICRA does not foresee further support to LCPL or upstreaming of funds to Setco Automotive Limited (SAL) or any other Group entity, but the same will remain a key monitorable. The company is also exposed to the cyclicality in the auto industry, as evident from the volatility in the top line over the past fiscals.

The rating, however, notes the extensive experience of the promoters, SASPL's established operational track record and strong relationships with original equipment manufacturers (OEM) in the M&HCV clutch manufacturing business. The rating also considers the improvement in SASPL's operating profile over the past two years, post infusion of funds through NCDs, which led to streamlining of the business. Consequently, the total revenues increased to Rs. 559.2 crore in FY2024 (on a provisional basis) from Rs. 475.0 crore in FY2023 and Rs. 262.0 crore in FY2022, and the margins improved to 12.2% in FY2024 from 11.3% in FY2023 and 7.9% in FY2022.

The Stable outlook reflects ICRA's expectations that SASPL will continue to benefit from its established operational track record, extensive experience of the promoters and its reputed customer base.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters and established operational track record of the Group in auto component industry – SASPL is managed by Mr. Harish Sheth, who has an experience of over 35 years in the auto component industry. The company manufactures clutches primarily for medium and heavy commercial vehicles (MHCV) and the Group has an established operational track record of nearly 35 years. The company's revenues are distributed across three key segments **–** OEMs, original equipment suppliers and independent aftermarket. It has also forayed into manufacturing clutches for the tractor segment and allied parts like lubricants, brake lining, fly wheels, and auto components in the MHCV segment.

Strong relationships with OEMs along with repeat business from major OEMs – The company has developed an established customer base, resulting in repeat orders. It has an established brand presence in the automotive market with reputed M&HCV OEMs in India.

Credit challenges

Weak financial profile, characterised by net losses and modest debt coverage indicators – SASPL's financial profile remained weak on the back of net losses as on March 31, 2024. It reported losses of Rs. 122 crore on a provisional basis in FY2024 (loss of Rs. 209.3 crore in FY2023) owing to lower top line and high interest expenses. Although SASPL's revenue rose 18% to Rs. 559.2 crore in FY2024 from Rs. 475.0 crore in FY2023, and the operating margins increased to 12.2% in FY2024 from 11.1% in FY2023, the company's debt coverage indicators remained moderate in the said year on account of high debt levels. In the near-to-medium term, ICRA expects the pressure on net profit and coverage indicators to continue, given the substantial debt on its books with the redemption falling due in FY2026.

Significant debt with accumulative interest and redemption falling due in FY2026 – SASPL has a significant debt repayment obligation of Rs. 565.0 crore in FY2026, along with the accrued interest till the said year. The company is further expected to raise Rs. 20 crore in H1 FY2025 through NCDs. SASPL is required to mandatorily pay 5% coupon interest per annum on NCDs with an option to prepay the accrued interests from time to time, which will depend on the company's ability to generate healthy cash flow from operations. The ability of the company to make timely repayment of NCDs and the accrued interest generated till FY2026, through either refinancing or in-house cash flow generation or any equity support, remains critical for the credit profile and will remain a key monitorable.

Stressed financial profile of associate entity, LCPL, which continues to be under default – LCPL, in which SASPL has a 10.31% shareholding, started commercial production from April 2016. It has an installed casting capacity of 30,000 MTPA. LCPL has been reporting losses for the past seven years owing to internal challenges such as higher rejections and lower yields. LCPL could not service the debt obligation in FY2020 due to high losses and internal challenges. The company underwent debt restructuring in FY2021, providing a much-needed liquidity buffer to LCPL through an elongated repayment period, along with lower interest costs. The company was unable to service the debt obligation in FY2022 and FY2023 as the internal challenges continued. SASPL supported LCPL in FY2022 from the NCD funds and equity for maintenance capex and stabilisation of business. ICRA notes that SASPL has further given Rs. 10 crore to LCPL in FY2024 from its own cash flows against the earlier understanding of not supporting LCPL from its own cash flows, post the last support extended in FY2023. However, the money was advanced on the pretext of Ind-RF extending a further loan of Rs. 20 crore to SASPL, which would reimburse the support extended to LCPL. Hence, the same was largely a stop-gap arrangement. ICRA does not foresee further support to LCPL or upstreaming of funds to SAL or any other Group entity, but will remain a key monitorable. LCPL underwent a major maintenance exercise in FY2023, which mitigated the internal challenges faced earlier, improving its yield and rejection rates in FY2024.

High exposure to cyclicality in auto Industry – SASPL primarily caters to the automobile industry and manufactures clutches used in MHCVs. Thus, it remains exposed to the cyclicality in the auto industry, evident from the volatility in the top line over the past fiscals. However, supplies to OEMs account for approximately 32% of the top line, and the balance 68% comes from the replacement market.

Liquidity position: Stretched

The company's liquidity profile remains stretched, with almost full utilisation of working capital facilities, reflected in ~99% average monthly utilisation of the fund-based working capital limits during the 13-month period ended on April 30, 2024. Moreover, the company has significant debt obligation with accumulated interest due in FY2026. The company's ability to successfully manage timely redemption through either refinancing or in-house generation of cash flows or any equity support, remains a monitorable.

Rating sensitivities

Positive factors – A large maturing debt obligation in FY2026 against its earnings constraints the possibility of any rating upgrade in the near term. However, any meaningful reduction in debt, coupled with sustained improvement in its sales turnover and profitability along with liquidity, strengthening the entity's overall financial profile, would be a credit positive.

Negative factors – Any sharp decline in revenues and profitability on a sustained basis, or any stretch in the working capital, weakening SASPL's liquidity and financial risk profiles, may trigger a rating downgrade. Any support extended to its parent entity or any other Group entity, materially impacting the liquidity profile of SASPL, will also be a negative rating trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

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 OEMs. In 2000, GIDC stepped out of GSAL, and the latter was renamed as Setco Automotive Limited (SAL). SAL manufactured clutches primarily for MHCVs. SAL's clutch business was transferred to its wholly-owned subsidiary, Setco Auto Systems Private Limited, on a slump sale basis in September 2021. SASPL now manufactures clutch products. There were no operations under SASPL before the slump sale. SASPL sells clutches under its own brand, LIPE. SASPL is managed by Mr. Harish Sheth, who has an extensive experience of over 35 years in the auto component business. The company has its own manufacturing unit at Kalol, Vadodara (Gujarat) and an assembly unit at Sitarganj, Udham Singh Nagar (Uttarakhand). The company's research and development centre along with its manufacturing facility are approved by the Department of Science and Industrial Research (DSIR). The manufacturing facility is also certified by IATF 16949, ISO 14001 and OHSAS 18001.

In addition to OEMs, the company caters to clutch demand from original equipment services and independent aftermarket, which together contributed 63% to its annual sales in FY2024. The company has recently forayed into manufacturing of clutches for the farm segment (tractors) and has supplied products to major tractor manufacturers like Eicher Motors, Sonalika

Tractors among others. SASPL also ventured into new business segment of allied parts (shop and ship) like lubricants, brake lining, fly wheels, and auto components in the MHCV segment.

Key financial indicators

Consolidated	FY2022	FY2023	H1 FY2024*
Operating income	262.0	475.0	256.4
PAT	-173.0	-209.3	-65.4
OPBDIT/OI	7.9%	11.1%	10.3%
PAT/OI	-66.0%	-44.1%	-25.5%
Total outside liabilities/Tangible net worth (times)	-2.9	-1.9	-1.7
Total debt/OPBDIT (times)	16.0	11.3	11.3
Interest coverage (times)	0.3	0.4	0.3

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; * Unaudited numbers*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	
					May 21, 2024	Aug 7, 2023	Aug 12, 2022	Aug 18, 2021	Jun 02, 2021
1	Non-convertible Debenture	Long term	215.00	215.00	[ICRA]B-(Stable)	[ICRA]B-(Stable)	[ICRA]B- (Stable)	[ICRA]D	[ICRA]D
2	Non-convertible Debenture	Long term	350.00	350.00	[ICRA]B-(Stable)	[ICRA]B-(Stable)	[ICRA]B- (Stable)	[ICRA]D	-
3	Proposed Non-convertible Debenture	Long term	20.00	0.00	[ICRA]B-(Stable)	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible Debenture	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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE0I0R07011	Non-convertible Debenture	Sept 1, 2021	5%	Sept 1, 2025	215.00	[ICRA]B-(Stable)
INE878E07010	Non-convertible Debenture	Sept 6, 2021	5%	Sept 6, 2025	350.00	[ICRA]B-(Stable)
Unplaced	Non-convertible Debenture	-	-	-	20.00	[ICRA]B-(Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis : Not Applicable

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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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