

Setco Automotive Limited
Quarterly Results Conference Call
February 19, 2018

- Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Q3FY '18 Setco Automotive Conference Call. On the call today, we have with us Mr. Udit Sheth, Joint Managing Director and Mr. Vinay Shahane, Vice President, Finance of the company. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing '*' and '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vinay Shahane, Vice President, Finance, of Setco Automotive. Thank you and over to you, Sir.
- Vinay Shahane:** Thank you. Welcome Ladies and Gentlemen to Setco's conference call to discuss the December quarter results. The results and investor presentation is available with you. Giving the highlights of the performance, the sales during the third quarter grew by 21% year-on-year. EBITDA was around 37% year-on-year and PBT growth was 260%. EBITDA, as we had discussed in the earlier call also, continues to show the improvement with increase in volumes, better efficiency, and cost optimization measures which the company has undertaken and as a result, the EBITDA for the quarter is at 14.9% compared to 13.2% in the same quarter earlier year and 13.9% in the second quarter of the current year and we are hopeful that this trend will continue and overall sales outlook as we have continuously maintained is looking optimistic, quite strong. The industry feedback and the undercurrents are strong and we expect the similar growth trajectory to continue in the fourth quarter as well as the coming Financial Year. These are the broad highlights. We can now start with the question and answer.
- Moderator:** Thank you. Ladies and Gentlemen, we will now begin the question and answer session. We will take the first question from the line of Payal Malwaliya from WOW investors. Please go ahead.
- Payal Malwaliya:** My question is about Lava Cast Private Limited, I just read in the investor presentation that you will start getting orders in next few months, so are there any orders on hand right now and what kind of capacity expansion you are looking for and currently what is the capacity utilization?
- Udit Sheth:** We already have started supplies in Lava Cast to Setco Automotive, Lava Cast being 80% subsidiary of Setco Automotive has been supplying quality grey and SG Iron castings for the

clutch, cover assemblies, and pressure plates and bearings and these have not only been used for the domestic market both for the OEM and the aftermarket, but we have also been able to now break into the international market and our new supplies to North America are using the castings coming out of Lava Cast . We have an installed capacity of 30,000 tons, 27,000 to 28,000 per annum to be more precise, and currently, we are hopeful to ramp up to around about 2200 to 2400 tons per month by around July-August latest. Currently, by the end of this quarter, we should be able to take it up, in my opinion, to about 1800 tons and we have also received orders outside of Setco Automotive. We are in the sample approval stage and all suppliers will be starting in this current quarter to Tata Motors, Ashok Leyland, and to ZF, so Lava Cast is not just fully supplying only to Setco, but also has outside customers.

Payal Malwaliya:

How much you said by August, how much will be the capacity ramped up?

Udit Sheth:

By August we will be actually 2400 tons to 2500 tons per month, which will mean that we are operating at very high capacities and utilization and at that time we will be looking at the yield as well as the rejections. We have been able to substantially improve on both parameters already and this quarter will be our best quarter this current quarter, which is Quarter-4 will be our best quarter in Lava Cast because it is ramping up from a very low base.

Payal Malwaliya:

Sir, one more thing you have been giving an outlook of say EBITDA margin of say 15% for the future on the presentation, 15% to 18% growth, right, in sales?

Vinay Shahane:

Yeah, right.

Payal Malwaliya:

Then what kind of expansion Setco is looking for?

Udit Sheth:

Setco's expansion basically is to augment currently to ensure that we are going to focus on the Euro VI norms, the new clutches. Most of them are under the development stage, a couple of them are already developed. We are very confident of hitting the timelines that the OEMs have put into place. As a company, we have no major capital expenditure planned as a company. Our major CAPEX is only to upgrade the existing plant and machinery and to augment the capacities and there will be a lot of investment into toolings, which will be required for the Euro VI.

Payal Malwaliya:

How much CAPEX that could be in the numbers?

Udit Sheth:

Regularly, on an annual basis we have been investing about 30 crores in our capital expenditure year-on-year. It could be may be +/- 15% at best on top of that.

Payal Malwaliya:

What kind of finance cost are you looking forward to incurring?

Vinay Shahane:

For the additional finance you are asking or overall?

Payal Malwaliya: Additional.

Vinay Shahane: The additional CAPEX average cost of borrowing currently is around 10.25%.

Payal Malwaliya: Okay, that will remain at par?

Vinay Shahane: Only with the improved performance and improved credit rating perhaps it can further lower only, but not beyond this.

Payal Malwaliya: You are expecting a credit rating upgrade, right, Sir?

Vinay Shahane: Yeah.

Payal Malwaliya: One more Sir, how much is your revenue into your subsidiary as well as I wanted your revenue bifurcation in the casting, into OEMs, I needed a bifurcation which is done?

Vinay Shahane: Can you be little clearer, I did not get you exactly?

Payal Malwaliya: Actually, Sir, I wanted your revenue bifurcation, how much percent revenue comes from **OEM, After Market and Exports**

Vinay Shahane: OEMs contribute around one-third of the total revenues between 30% to 35%, around 60% is the aftermarket, and balance 5% to 10% is the international business.

Payal Malwaliya: I just heard about an auto policy coming, yesterday or day before there was a new news about government auto policy news, now how is it going to affect our company?

Udit Sheth: Market impact for this is going to be phenomenal because if one is to obviously bring out a policy, we are very good with policies, but policy implementation is another discussion altogether. Assuming that the government is able to implement the scrapping of older vehicles which are more than 15 years, there isn't enough capacity currently in the market to meet that demand, so they will have to take a very phased approach to scrapping those vehicles, but in our opinion it is going to be fantastic for us because they are going to be obviously replaced.

Payal Malwaliya: Overall, you are looking towards positive outlook?

Udit Sheth: So, year-on-year there could be, if they actually take a backlog of vehicles, year-on-year they will have to start by scrapping minimum half a million vehicles or higher. We do not have the capability of filling half a million vehicles because our highest capacity today has been about 350,000 vehicles annual production from all the OEMs, so it is going to be great for us, it is a good problem to have and I am sure the OEMs are also augmenting their capacities to meet this demand. Being a near monopoly player is going to have a fantastic effect on us, but as a

company we have to focus on our capacities, we have to focus on our supplier capacities both.

Moderator: Thank you. The next question is from the line of Mitul Shah, an Individual Investor. Please go ahead.

Mitul Shah: Sir, my first question is regarding Lava Casting, how much revenue is coming from the Lava Casting?

Udit Sheth: Currently, quarterly or monthly, how are you looking at it?

Mitul Shah: Even if you can give for this quarter also in the future guidance for the monthly also if you can give?

Vinay Shahane: Currently, for this current financial year, the total revenue could be around 90 crores on standalone basis --more than 90% to 95% will be to Setco's supplies, so it will not reflect on the top line.

Mitul Shah: But how much margin is there, even if they are supplying to Setco, how much margin they are putting there?

Vinay Shahane: The margin is at arm's-length and fair market pricing, we do not really have the flexibility to adjust or manipulate the prices.

Mitul Shah: Sir, my main question is almost all the OEMs, if I talk about the Ashok Leyland, Bharat Benz, Eicher, all of them have shown from last year more than 50% growth and we are showing growth of around 30% to 35%, so what was the reason that we were showing the revenue growth of 21% and by all the other players in case of the players you are supplying, they have shown the growth of more than 50%, so is there any reason that why there is a discrepancy between these numbers?

Vinay Shahane: I would like to highlight what we are mentioning the Tatas and Leyland, you have mentioned more than 50% I agree our sales, as I have mentioned earlier comprises of OEM, aftermarket, and international business. You have to just look at the graph of sales increase what we have with our investor presentation, OEM sales for the quarter have grown by 57%, however, aftermarket which is around 60% of the revenues is not growing at 50%, it is at a double-digit growth but still not 50%, so 21% is a weighted average sales revenue growth, so OEM volumes have grown 55% in Quarter-3, so we are in market and when I am around 90% market supplier of clutches to these OEMs, naturally my growth will be in line with their growth.

Mitul Shah: Is there anything for the future guidance that you have said that you have done the costing optimization plus there is a balance sheet improvement, so what kind of costing that you

have controlled that is why it has shown the improvisation that is I wanted to know and in future what are you going to do for more costing control?

Vinay Shahane: The cost optimization or cost improvement is a continuous process for us, it is not a one-time exercise, so; it is a continuous process first of all. Secondly, the better costing improvement will come from vendor sourcing, alternate sourcing, economies of scale, improvement in efficiency, better machines, the CAPEX which will be spent on upgrading the machinery will improve the yields and reduce the cost, improving the rejection costs, reducing the rejections, all this will contribute together to a substantial cost improvement.

Udit Sheth: Also, you need to take into account that being in an engineering sector, higher utilization of capacity is what will result in a better bottomline, cost we have to focus on material cost obviously that being the biggest chunk of what we have. We have also invested for the future, in fact our last year and the year before, we have taken a higher cost burden on our P&L which now will get augmented over the next three years because it is going to be a growth without that much more fixed cost increase.

Mitul Shah: That will be due to Lava Casting?

Udit Sheth: Lava Cast is only the growth on one aspect of it and it is a separate subsidiary, but even with automotive, for example, people, we have invested for the future, now that we do not need to augment that any further. We have got the right people in place to at least take this company over to the next two to three years. Similarly, we will be with the better utilization of our capacities like last nine months, this year first quarter was abysmal for us why because there was a post-GST rub off on us, there was inventory augmentation, so all of that is now behind us, so putting that ahead I think the best three years are now ahead of us.

Mitul Shah: Sir, last question, what do you see that how much percentage of unorganized stream was in to your sector and how much you are seeing transforming into the organized thing?

Udit Sheth: It is a very ambiguous question and the answer is also equally ambiguous.

Mitul Shah: Sir, you know that how many your competitors were there and how much business is coming to you that is why I am asking?

Udit Sheth: Exactly, let me answer that question and just to give you a very simple perspective of the clutch market. We have almost 90% to 95% of the OEM market. We do not expect that share of business to change substantially growing forward into the growth. The question is the OES channel, OES channel also we have exclusive relationship with our customers, so that I believe is an unaffected market segment as far as we are concerned. The third part is the independent aftermarket. In that normally in the first two owner, every vehicle goes through about three or four ownership cycles that is 12 to 15 year cycle. Normally, after age eight,

after the first eight years of ownership people go on to the spurious market and that is the market we do not even get into because that is where there is a guy will pay anything specifically for the replacement market, so we want to ensure that and we do not build in two different qualities. Our quality is the same across all three segments, and therefore, we believe in life-cycle management and the lowest rupees per mile from the way we operate, so there is no penetration from the unorganized sector into our sector, that would be the right way to put it.

Mitul Shah: Once the Euro VI will come, are we going to see a huge jump in growth or it will be the same as before?

Udit Sheth: The growth will be similar to what the OEM sector grows.

Mitul Shah: But aftermarket?

Udit Sheth: Aftermarket is going to have two to three year lag because normally the replacement market kicks in after two to three years, after the warranty cycle which is a two-and-a-half month warranty cycle is finished, that is when your aftermarket kicks in.

Mitul Shah: From where you are seeing the major growth will come?

Udit Sheth: In clutch business, major growth is generally coming out of the OEM market because the guy who is fit into the OEMs is the guy who is preferred in the replacement market, so as long as the OEM sector continues to maintain our share of business, we will continue to dominate the OES and aftermarket as well and we believe, we are in that direction.

Mitul Shah: But the OEM share of yours is only 33%?

Udit Sheth: OEM share...

Mitul Shah: Of your total revenue is 33% to 35% that was my point, so can we do something to increase it or something because aftermarket is not that much growing, that is why I am saying and next two to three years, the OEM is going to get bigger growth of the pie?

Udit Sheth: Let me once again try and just put this across to you, our overall production share of business has nothing to do with market share at OEM level.

Mitul Shah: As you are having 95%, okay, got it.

Moderator: Thank you. The next question is from the line of Kush Gangar from Care Portfolio Manager Services. Please go ahead.

Kush Gangar: Sir, I just wanted to understand on the Lava Cast side, you mentioned that we are expected to do 90 crores of revenue for the financial year and we are currently producing around 1800 MT per month so it is around 20,000 per annum, which is around 70% of our utilization whereas it is mentioned that we will only use one-third of the total capacity for in-house and the rest would be, one-third would be exported and one-third would be sold to OEMs domestically, so I just wanted to, the numbers are not matching up, that is the reason I asked this question?

Udit Sheth: It is a very good question, when we spoke about this in the previous time, the objective was the overall philosophy of Lava Cast, the overall philosophy. Having said that, our obvious answer is going to be that the first offtake is going to be to Setco Auto, to stabilize Setco to ensure that our own production processes and quality also stabilized. Once that is done, there will be confidence to go to the market. Once that market is accepted in the Indian aftermarket then we look at export and export and Indian aftermarket, the 33, 33, 33 is on an expanded platform of Lava Cast, I think between domestic OEMs and Setco our capacity is going to be used up by the time we hit August-September in 2018-19.

Kush Gangar: This current 90 crores is an 1800 per month, right, I just wanted to check we are not producing and then keeping the inventory after say couple of months when we receive the approvals, we shift those goods to them?

Udit Sheth: I want to clarify one thing for the purpose of the call that in the first quarter, we had very little capacity utilization in Lava Cast because it was an abysmal quarter, 700 to 800 tons is what we have poured for example, it has been on an increasing balance, so you cannot take 1800 into 12 months, it is ramping up now. Now is the time we are coming to capacity utilization which by the second quarter of next financial year will hit the targets which we wanted to.

Kush Gangar: Are we at breakeven level or what would be the utilization level when we would kind of breakeven?

Udit Sheth: By the end of this quarter, we should be able to hit the breakeven levels.

Kush Gangar: I just wanted to understand on the tractor side, as you said that we have 90% to 95% share in the MHCV segment, so the growth drivers in terms of OEM sales would be either the market growth and our entry into newer segments like tractor and passenger vehicles, so if you can just share some highlights or details on that segment then how do you see that shaping up over the next couple of years and our medium-term target?

Udit Sheth: The outlook for the MHCV is going to be continuing to grow at the pace which we have already mentioned. We are seeing an increased opportunity from the mining sector, infrastructure, and new road construction which is coming up, the new highways spend and

of course what I just earlier highlighted, the scrapping of the old vehicles which will I think be a very large contributor. There is going to be demand which possibly the market may not be able to cater to, so that is taking care of our MHCV. As far as the farm tractor is concerned, we have broken into one major OEM and supplies have started. We expect that in the next year or so, we should break into four to five OEMs for the farm tractor segment and that is going to add additional top line turnover of in my opinion in the next two years of 150 crores in this business.

Kush Gangar:

One more question on the single clutch and dual clutch system, as it is mentioned that the market is kind of shifting from single clutch to dual clutch?

Udit Sheth:

We meant in tractor segment specifically, not in the MHCV segment, MHCV segment in India is a single clutch segment. What is happening is the size of the clutch is increasing, so they are going to 17 inch and 15 inch clutches with bigger disk centres, but they are not double clutch. Double clutches are mainly for the North American market.

Kush Gangar:

In terms of, I read that some of our customers we cater to 100% of their requirement, so I just wanted to understand and are there no other players in the market or are we so good because in terms of customer side it is a risk from their perspective to be dependent on a single supplier, so what advantages do we have, is there no other competitor compared to us?

Udit Sheth:

I will put it very, very simply, we are not a monopoly, we are a near monopoly, so the customer is always keeping us honest by buying little bit from the other manufacturer, therefore, there are always keeping us both honest on supply and honest on price and we over a period of time, my father and the team have built a very strong reputation not just on delivery and price, but also on service. Being a local clutch supplier, we understand the dynamics of the market, we understand the abuse that is there in the market and lot of the global OEMs they try and sell in India, what is already off-the-shelf. The advantage that we have had in this market apart from our high-quality and our good pricing is that from day one when the BS III norms came into play in 2000-2001, we started becoming the favored suppliers, so the economies of scale and the kind of penetration that we have created with the existing OEMs has been so strong that we have been able to build on top of that legacy. Now, we are working on project to project, platform to platform with all of them and while the international OEMs, Tier-1 clutch manufacturers are always knocking on the doors, we have managed to really hold our position in this segment.

Kush Gangar:

Who would be, Sir, our competitors in India specifically?

Udit Sheth:

Valeo of France manufactures MHCV clutches, but their core sector is the car segment, LUK manufactures some, they contract manufacture of some clutches for the aftermarket, nothing in OEM but they are a dominant player in the farm tractor segment.

Moderator: Thank you. The next question is from the line of Meet Jain from Prithvi Samvad. Please go ahead.

Meet Jain: Sir, can you provide me with the revenue breakup of heavy commercial vehicles, medium commercial vehicles, passenger into the OEM segment?

Vinay Shahane: We do not have passenger vehicle segment, can we share this off-line.

Meet Jain: The other question is like if there is a raw material fluctuation, price fluctuation, so how do you manage that is a pass-through or something?

Udit Sheth: Normally, there is a pass-through, there is a time lag in the pass-through but they compensate you for the time lag, so that is not too much of a problem. Recently, though there has been pressure on improvement of efficiency as well, but normally raw material pass-through is something that comes through in three to four months minimum. We do not get compensated for the interest cost of those three to four months, let me make it very clear, but we get pass-through. We are able to get our raw material increases sorted out.

Meet Jain: The government is pushing towards electric vehicle like automatic transmission vehicles, so how do you think this will impact to our company?

Udit Sheth: Automatic transmission, I will address first. In commercial vehicle sector, automated transmissions are not there. In the bus segment especially the low floor airport buses have the automated and manually automated transmissions. In most of this transmissions also there is a clutch, only thing is that there is no driver impact on the clutch, the clutch is automatically actuated and deactuated, so that is the automatic side. The electric vehicle side is right now very, very prominent thought process only on the car segment. When it comes to the trucks, they are actually talking about hydrogen fuel cell technology, which is very different from the electric vehicle technology and it is still under development. It is minimum a 10 to 15 year cycle before they find anything which is mature enough and capable enough to handle the demanding operating conditions in India.

Moderator: Thank you. The next question is from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: **Yeah, hi sir. Congrats on a good set of numbers.** I have two data point questions, what is the debt on the standalone and on the consolidated level as of December 31st?

Udit Sheth: Thank you for your compliment, we will just share with you the numbers off-line and we will send it across to you.

Digant Haria: I just wanted to check two more things, one is that we have already seen that last two quarters, we have done an EBITDA of close to 20 to 22 crores per quarter, so that is almost a

cash flow of almost 15 crores a quarter and almost 60 crores a year in the standalone company, so what do we plan to do with the 60 to 70 crores of cash flow which is getting generated, like are we going to think of repaying debt or most of it will go in the expanded working capital because our sales is also going to increase at a decent rate, so how should we look at this entire cash flow management for next 12 months?

Vinay Shahane: Basically, I think perhaps you have answered the question itself, one of course growing volumes, increasing working capital of business requirements will be taken care, plus of course the CAPEX for the routine and upgradation CAPEX what we will be incurring, the funds will be utilized of course towards that and any surplus funds naturally will be ploughed back in business to reduce the overall borrowing and the interest cost.

Digant Haria: Like, should we think of that absolute debt will remain same or maybe decreased 12 months from now?

Udit Sheth: It would decrease and also we have got to ensure that Lava Cast also becomes an extremely strong organization, so our entire focus is going to be on ensuring efficiencies, yields, and debt are better positioned within the organization, no major CAPEX as I have already discussed, 40 to 42 crores is the estimated CAPEX for the coming year.

Digant Haria: Lastly, I have some question on Lava Cast, like lot of questions have been asked, but I just wanted to know what could be the revenue of Lava Cast when we have 12 full months of full utilization, August '18 to August '19 will probably be at full utilization, those 12 months so what could be the revenue potential of that company?

Udit Sheth: About 170 crores should be the top line.

Digant Haria: The EBITDA margins, would it be 15% as we have in the standalone company or it should be a little lower there?

Udit Sheth: No, it should be about 14% over there, being a new company our focus is on improving the yields and lowering the rejections and also ensuring that the starting and stoppage of the furnace has very least impact on the power cost, so I think there will be some fluctuation in the EBITDA, but we are quite confident of getting 14% to 15% in the Lava Cast because it is not just pouring, we also have a fully owned machine shop, so we are not just giving raw casting, we are giving fully machined castings where we are able to better our margins.

Digant Haria: Lastly, you said that you already have approvals for Lava Cast to sell their products to Tata Motors, Ashok Leyland, and ZF, or these approvals are in process?

Udit Sheth: Tata approval has come through, the pricing approval has come through; Leyland approval has come through so as ZF approval come through, we are going to supplies in this coming month of March.

Digant Haria: Once we reach that 170 crore mark maybe that 33, 33, 33% is what we will try after?

Udit Sheth: That will be in the year '19, '20 onwards we will look at that.

Moderator: Thank you. The next question is from the line of Kashyap Jhaveri from Emkay Fincap. Please go ahead.

Kashyap Jhaveri: I have got three questions on the FY '18 outlook and one question on Lava Cast, on FY '18 numbers we had a projection of about 14% sales growth in Q2 which now seems to be revised downwards from about 10%, so what has driven that, is this because aftermarket and exports have grown slower than what we anticipated and any reasons for that? Question number two is on EBITDA, we were expecting about improvement of about 200 basis points over Q2 in H2, that has worked to about 100 basis points, so any outlook over there? Question number three is have the preference shares in Setco Engineering Private Limited we predict of about 33.5 crores or any timeline for the reduction?

Vinay Shahane: I will take the last question first. Full preference shares investment of 42.65 crores has been redeemed during this quarter - up to this quarter in stages, so there is no preference share outstanding as of date. The earlier question was about the EBITDA improvement of around 200 basis points what we had indicated in earlier con call was in the Q4 EBITDA estimations or expectation what we had given and if you see in this quarter over Q2 there is already an improvement of around 100 basis points, so we are in the same trajectory only. As it is again as we have mentioned earlier, it is partly a volume game also as the volumes go up beyond a breakeven point, the additional profit margin and the EBITDA will be improving in a geometrical proportion rather than arithmetical proportion. What was your first question?

Kashyap Jhaveri: Sales outlook which has been revised from 14% to 10% for FY '18?

Vinay Shahane: The sudden upsurge in activity and demand from second quarter after the GST implementation, has put strain on supply chain, basically the Tier-2 suppliers because the OE demand also has grown up as well as the Tier-1 suppliers like us are demanding more from our Tier-2 suppliers, so we are facing certain supplier constraints and what we were looking at the growth potential could not be achieved. OEM segment of course is registering the growth what market is demanding, but aftermarket segments are little lagging behind than what we could have delivered, but are not able to deliver only because of supply constraints. But we are addressing all these issues including vendor development etc. and we hope next financial year we will not have those issues.

Udit Sheth: Also to just to give you a little bit more picture on the exports, some of the plans that we had which was pretty aggressive, they possibly have at best a delay of a quarter or two because the supplies to America have started and our initial feedback is that the market is really appreciating the product and there is a better than expected pickup in that market. Similarly, we are seeing a lot of traction for our Russian business and again being a highly bureaucratic organization of the country, the offtake is lower than expected, but we are on target to get the offtake, so exports is going to play a very significant role going ahead.

Kashyap Jhaveri: Last one question on Lava Cast, can you give the quantitative numbers for this quarter production revenue and EBITDA or loss at EBITDA level if any?

Udit Sheth: Not forward-looking.

Kashyap Jhaveri: I mean for this quarter, Quarter-3, we have given this till Q2 in presentation, now this quarter onwards it is not available, so?

Udit Sheth: We normally do it half yearly, so we will give it to you at the end of the year.

Moderator: Thank you. The next question is from the line of Komal Jain from Nevshay. Please go ahead.

Komal Jain: Sir, my first question is I would like to know whether our subsidiary started making profits both American and UK?

Udit Sheth: The American subsidiary has started making a profit, we are expecting a decent performance at the end of the year. The British subsidiary is at a breakeven. It is not making a profit and we do not expect that to change substantially because in both the cases, we are looking to retain significant profits in India itself. One of the things now that we are looking into because the American tax structure has changed, we will have to look at that overall pricing mechanics, but otherwise, we are retaining majority of our profits in India and our products is priced in that manner.

Komal Jain: Sir, second question in America we are only manufacturing hydraulic pressure converter or we are also manufacturing clutches?

Vinay Shahane: US subsidiary is manufacturing hydraulic converters at their own facilities, the clutches are manufactured in India and supplied to the US market, they are supplied through our US subsidiary.

Komal Jain: Sir, for UK also we are supplying clutches from India or there we have?

Vinay Shahane: Yes.

Komal Jain: My next question is regarding Lava Cast, we are meeting the demand for Tata and Ashok Leyland, so previously who are we relying, is it domestic market or they are relying on imports?

Udit Sheth: What has happened is that they are looking to ensure that their entire basket, they actually source about a quarter million tons of raw casting or machined castings on the market for which they may have 20, 30, 40 suppliers. What they are trying to do is to contain that entire supply group to maybe 10 to 12 suppliers who are at the highest standard of manufacturing with very high environment and quality standards and fortunately because of our new foundry and the investments that we have done both from a factory side as well as equipment side, we qualify to be part of that and also the more important bit is, they are experienced with Setco. Each of them have tremendous faith that they have put in to Setco to be able to supply 90% to 95% share of business and that same philosophy and way of working is also there in Lava Cast, so they can put significant faith in Lava cast also to meet their requirements.

Komal Jain: Sir, we are meeting their casting requirement or brakes and other things?

Udit Sheth: We are meeting the casting requirements in other component parts, so it could be chassis parts, drivetrain parts, powertrain parts, any of them, we are looking at things like bearing caps, flywheels those kind of things.

Komal Jain: Sir, can you give me some brief outlook regarding investment in **SE TransStadia**?

Udit Sheth: It is a completely different entity and you will have to take that up separately with that organization.

Moderator: Thank you. The next question is from the line of Jatin K. from GS Investments. Please go ahead.

Jatin K.: Most of my questions have been answered. I just wanted to understand a bit nuances on the 2020 guidance of 1000 crores, as you have already mentioned most of a big part of our revenue come from aftermarket which is not doing that well and there is a two to three years lag in terms of OEM sales to aftermarket, so how do we want to grow that as in how do we want to reach our 2020 guidance in terms of how much would be aftermarket and how much do we expect to gain from OEM and how much new business do we want to get it?

Udit Sheth: The overall outlook is to give you a consolidated outlook of the entire organization, that is, Setco in India globally as well as our foundry business. When you put the entire piece together by 2020, we should be easily hitting that number. As far as your question comes on aftermarket as well as OEM, our growth is going to be commensurate to the market growth, we can do better than that. Whatever the OEM is going to be buying from us, we should be

able to supply that entire demand and we are augmenting capacities for that and that throughput goes into the OES and aftermarket, so we are going to be having what do you call it constant growth in each of these segments, we are going to get some accelerated growth out of our export market which is going to be close to about 15% of our overall sales and also from the farm tractor market, which we are expecting to have about 150 crores of turn in the next two to three years.

Jatin K.: Sir, as we increase the growth and fixed cost remain same, do we expect margin to go up from here?

Udit Sheth: I certainly hope so.

Jatin K.: Do you want to give any color on how much margins are we expecting by 2020?

Udit Sheth: We spoke about it in the previous call, our target is going to be between 17% and 19% EBITDA and anything worse than that is not something that we would feel too happy about.

Jatin K.: Sir, what is our working capital requirement?

Vinay Shahane: Working capital requirement employed currently, today is around 140 crores, which we are sure will be able to tighten, improve it, and increase growth what we are talking about 1000 crores in this area will be possible with may be only minimal increase in the current working capital levels.

Moderator: Thank you. The next question is from the line of Ajay Khandelwal from BOI AXA Mutual Fund. Please go ahead.

Ajay Khandelwal: Sir, we have great business and we are dominant in practically all categories that we are in, my question is regarding margin profile and return on capital deployed, how we approach this keeping in mind that we have a gross block before Lava Cast I think it was 470-475 crores, we added some 180 to 200 crores on it, I would have thought that this kind of expenditure we are doing, ideally the captive users also our margin should have been higher because as currently before Lava Cast we were outsourcing it and we were doing similar kind of margins, so with spending so much of money, our margin profile should have improved drastically keeping in mind we have after market and we have the pricing power I assume there at least in aftermarket, so how do we approach about this return on capital, how we are planning to improve it, what are the decisions we take keeping in mind threshold return perspective whenever we go into another CAPEX so what is your thoughts on that?

Vinay Shahane: I appreciate your question, basically I think what you are asking clarification is on return on capital employed, how the decision on the CAPEX or more particularly about the Lava Cast investment of 180 crores is what you are looking, so I believe you are looking at a

consolidated picture and not the standalone picture. Now, let me clarify, okay the Lava cast 180 crores investment basically was essential for Setco to have the growth plans of 1000 crore turnover because, if you track the company and seen the earlier results and the con calls, Setco's performance or the sales volumes were getting affected adversely because of lack of quality and consistent supplies of castings and that is where we were losing the top line, so it was necessary to have a reliable quality supplier of casting so that Setco achieves the growth of 20%, 25% CAGR what we are looking at with 1000 crore in two years' time, so without that 180 crores whatever the margin Lava cast would be looking at like Udit said earlier around 15% EBITDA is not the return we are looking at the group level, but it is the EBITDA or the contribution what that casting supply will give to Setco and grow is really the profitability or the return on investment we are looking at. If that investment was not there, Setco would have perhaps grown at a nominal rate and not really, I would say, more than average or more than expectations growth of around 20% to 25% CAGR, so we will have to look it in that perspective. Lava Cast is in first year of operation last year, as we said it will be really stabilizing at normal operation level in FY '19 and so that would be a real test to compare the results and analyze about the decisions were taken whether they are right or wrong, FY '19 will really talk about it, not really FY '17, '18 will not be a fair judgment to pass on.

Udit Sheth:

We share your concern, we are working on each and every of this parameters as well, but it is very interesting, it is a good question you have asked but contrary to that you would have also noticed that we as a company from 2005 onwards, we have possibly given a 58 return on our stock, which has actually gone from Rs. 20 value at that time to about perceived value today of Rs. 980, so in a way while we have always been very, very careful on how we are spending our capital and controlling our cost, we have also ensured a very significant return to all our shareholders over this decade.

Ajay Khandelwal:

I am saying there are no two questions about it, we have made a fantastic business, extremely formidable business and there is practically no competition to it, the only concern that people have is about as I have spoken about that somewhere we have invested in couple of projects which are not exactly in sync with our current business and there are some maybe preferential outstanding whereas in this company itself, there are high cost borrowings and the international operations, so if there is some clarity on how to go about this capital deployment, I think business wise people do not have any concern and I think it is a great business, so if we can clarify in public domain that this is the kind of return on capital we are looking at in all the going forward whatever ventures we get into, then that will be all the at least doubts to the mind of investors?

Vinay Shahane:

Just to put the facts correctly, there are no preference shares outstanding at current point as we have clarified earlier also. Whatever preference shares were mentioned, were at 9% dividend, on a cost basis it was breakeven for the company. But anyway it is not there and company does not intend also to have any further investment. As far as the target or what

the return on capital should be, definitely we do realize it has gone down in recent years because of investment in Lava Cast or investment in our R&D facility or diaphragm manufacturing facility in-house, which would be return on the investments will come in next couple of years because R&D efforts will be a continuous effort which will not have tangible result immediately in top line or bottom line, it will be spread over a longer period, so that investment will look as done, but no tangible results will be visible. Target of course will be to reach 20+ on a return on capital employed, when we reach around this 1000 crore turnover beyond 2020.

Moderator: Thank you. The next question is from the line of Nitin Gandhi from KIFS Trade Capital. Please go ahead.

Nitin Gandhi: Just I wish to reconfirm some of the facts which we have shared, our aftermarket is growing at 10%?

Vinay Shahane: Right, 10% to 12% average. I clarified just a couple of questions earlier in Q2 afterwards when the markets are looking up, we have been facing some supplier constraints with Tier-2 supply and if that problems had not been there, which had affected our production capabilities also, that growth could have been higher.

Nitin Gandhi: That is what I wanted to re-confirm, that figure would have been how much?

Vinay Shahane: That could have been anywhere around 17% to 18%.

Nitin Gandhi: Our international business is growing at 20%, right?

Vinay Shahane: Currently, at 20%.

Nitin Gandhi: Can you share some more thoughts on, like you had explained how you went all ahead to set North America supply and other things, so you were expecting some 12,000 supplies, so when do you think that is feasible, now where do we stand?

Udit Sheth: Our budgeted target of 12000 units remains constant for a full year. I should be looking at that now starting from April onwards because the supplies took some time to take off but we have already started, we have seeded the market, we started selling. Now, we are seeing those orders pickup so I think this coming year you should be able to track 12,000 sets.

Nitin Gandhi: Fine, that remains at \$170 or so?

Udit Sheth: We are able to get a better margin because we are going directly to the customer over there and we are not going through our national distributor, so that distributor margin is something that we are going to retain with us.

Nitin Gandhi: That is extra 2%?

Udit Sheth: Not 2%.

Nitin Gandhi: Other thing is that Lava Cast, we are doing right now 1800, once it jumps to 2400 you said the turnover will be 170 crores approximately?

Vinay Shahane: Yeah.

Nitin Gandhi: And that will have 14% EBITDA, so next year at least tentatively average we should be closing at 1800 to 2100 level average for the full year and may be 10% margin for next year's projection I am just reconfirming?

Udit Sheth: Your talking about '18-'19?

Nitin Gandhi: Yes.

Udit Sheth: Your ballpark in the same.

Nitin Gandhi: Last thing is, you said farm equipment will have 150 crores business additional, what will be the margin on that and when do you see that 150 crore happening, FY '20?

Udit Sheth: You could say that.

Nitin Gandhi: Margin will be how much?

Udit Sheth: The tractor business will have as good or a better EBITDA than the MHCV, by 2020 we should be able to have a 15% to 17% margin on it.

Moderator: Thank you. The next question is from the line of Mulesh Salva from MM Salva Consultancy Services. Please go ahead.

Mulesh Salva: I just wanted to check are we planning to develop some new products for the same OEM producers because as I understand that there is a limitation now, growing 90% to 95% share in the particular product, whereas probably we can develop few other products and supply to the same companies?

Udit Sheth: We are focused on the market segments that we are in, only thing that will change is that we will be upgrading the noise vibration harmonics in these clutches to meet the Euro VI standards which come into force in the next couple of years.

Mulesh Salva: That means our growth will be co-related to the growth of the industry, we will not be able to grow higher than the industry?

Udit Sheth: In the MHCV sector, we will be growing commensurate to the MHCV sector growth. Over and above that our growth will be better than normal in the export as well as in the farm tractor segment because we are growing from a smaller base.

Mulesh Salva: In India, in domestic market our share is 90% to 95% whereas export, we do have scope to improve the market share?

Udit Sheth: Tremendously.

Moderator: Thank you. The next question is from the line of Kush Gangar from Care Portfolio Manager Services. Please go ahead.

Kush Gangar: I just wanted to check so in case the old vehicles which we are seeing, the policy comes and it is scrapped and there comes a tremendous demand from the OEMs since they will also have to increase the capacities and all, so the CAPEX requirement would then increase significantly or how do you see that side going forward?

Udit Sheth: Our CAPEX is in line with the perceived industry growth and we are confident that within that CAPEX, we will be able to hit the required market demand.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to Mr. Udit Sheth, Joint Managing Director of Setco Automotive Limited for his closing comments.

Udit Sheth: I really want to just thank all of you for taking the call and asking such insightful questions. We are happy for you to connect with us on a one-on-one basis. If there are any questions which are unanswered, please email them across or feel free to get in touch with us. We would also be happy for any of you to schedule a visit to our manufacturing facilities and understand more about what we do and how we do it. So we welcome you all over there and look forward to speaking to you again in the quarter or so.

Moderator: Thank you. Ladies and gentlemen, on behalf of Setco Automotive that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.