

September 25, 2020

To,

**Bombay Stock Exchange Limited,
Dept. of Corporate Services,
Phiroze Jeejeebhoy Towers,
Dalal Street,
Mumbai – 400 001
Company No. 505075**

**National Stock Exchange of India Ltd,
Listing Department
Exchange Plaza, Bandra Kurla Complex,
Bandra (East), Mumbai – 400051
Scrip Code: SETCO**

Dear Sir,

Sub: Transcript of Conference Call

We hereby enclosed the transcript of the Conference Call hosted by the Company on Monday, September 14, 2020 at 4:00 p.m.

The aforesaid information is also being uploaded on the website of the Company www.setcoauto.com

We request you to take note of the above on your record and oblige.

Thanking you,

Yours faithfully,

For Setco Automotive Limited


Chandra Kant Sharma
Company Secretary



Encl: As above



“Setco Automotive Limited Q1 FY '21 Earnings Conference Call”

September 14, 2020



**MANAGEMENT: MR. HARISH SHETH – CHAIRMAN AND MANAGING
DIRECTOR, SETCO AUTOMOTIVE LIMITED
MR. JS GUJRAL – CHIEF EXECUTIVE OFFICER, SETCO
AUTOMOTIVE LIMITED
MR. VINAY SHAHANE – CHIEF FINANCIAL OFFICER,
SETCO AUTOMOTIVE LIMITED
MR. ASHISH SAMAL – CORPORATE RELATIONS, PERFECT
RELATIONS**

Moderator:

Ladies and Gentlemen, good day and welcome to the Setco Automotive Limited Q1 FY '21 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for an operator by pressing '**' followed by '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Ashish Samal – Corporate Relations. Thank you and over to you, sir.

Ashish Samal:

Thank you. Good afternoon. And thank you for joining us on Setco Automotive's Financial Year 2020 and Q1 FY '21 Earnings Conference Call. Today, we have with us the Senior Management represented by Mr. Harish Sheth – Chairman and Managing Director, Mr. JS Gujaral – Chief Executive Officer, Mr. Vinay Sahane – Chief Financial Officer.

Before we begin, I would like to add that some of the statements to be made in today's discussion may be forward-looking in nature. We will begin the call with the opening remarks from the management, after which we will have the forum open for interactive Q&A session.

I would now request Mr. Harish Sheth to make his opening remarks. Over to you, sir.

Harish Sheth:

Good afternoon. I would like to take this opportunity to welcome you all on this particularly investor conference call. This has been a very unusual time, last seven, eight months, as you know. And that also is reflected in our results. First of all, combining both annual results along with the first quarter results, which is probably the first time must be happening with our company. I hope all of you are well in this COVID scenario, you, your family and all. Fortunately for us also at the company level, there are very few people who had to deal with COVID as such directly. Out of maybe 1,500 employees together, not more than 10 must have had to go through the virus. But they are all well, and there have been no casualties, which is the most important part.

As you are aware, industry, particularly commercial vehicle industry, when I am talking about, has been going through turmoil since last two years after reaching its peak in 2018-2019, when the production was the highest. In 2019-2020 it suffered considerably, the production was down by 55% over 2018-2019 production, and I have not seen anything like this ever before, such a huge drop. So, that was a big drop. It has a combined effect of very many things.

To start with in a small way, but GST, which made transportation quite efficient, the truck owners who used to take 10 days to go to Delhi and come back they could do the same round trip in eight or nine days. That improve efficiency, which is very, very good. Immediately after that, axel load increase of about 25% was permitted by the government, that hit vehicle manufacturers very badly, because suddenly there was an excess capacity in the market to the tune of 35%, 40%

because of that, combined with GST. And the last year, introduction of BS-VI vehicles. And with the Supreme Court coming out very clearly saying, 'no sale will be registered after 31st March'. It implies from January onwards, the dealers had started reducing their stocks, so all trucks can be registered when they are sold by 31st March. So March production went for a toss. Despite all this, reduction of 55%, our company, Setco Auto overall reduction in the business has been at about 30%. Because of the support from the aftermarket, we were able to withstand the big loss. But that's been history. And that has resulted in Setco declaring a loss this year. For the first time in its last 20 years since it came out, around 2001-2002, because of the pandemic we decided to skip out to dividend, which is also the first time.

Now the results are there. Let's talk about the future. Setco Auto, we feel that industry also has bottomed out to start with, so we see a gradual improvement in the vehicle production. Though overall this year vehicle sales could be down by about 20%, 25%, it's anyone's guess, but this is what we understand. But Setco Auto will still have a certain group, thanks to its aftermarket business. And we see this year as a comparatively much better year compared to the last year, and coming years would be still better for us.

And that's about that. I think we can start with the question and answers on that note. We are open.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Sameer Gupta, an investor. Please go ahead.

Sameer Gupta: I just have a few questions and I will ask them in one go. The first one is that we have seen that Q1 has been a really bad quarter for the auto sector, especially MHCVs, with most of them falling about 70%, 80%. But what kind of recovery are you seeing going into Q2 in terms of OEM sales? And this is the first one.

The second one is, you have mentioned in the presentation that there are some fixed cost savings that have been taken up by the company. So if you could throw some light on that on what are the kind of savings and will it be going forward, even continuing in FY '21 for the entire year?

And lastly, also, could you also throw some light on what are the diversifications that you have done, especially moving into tractor segment as well, apart from MHCV?

Jatinder S. Gujral: Good evening, everyone. I am JS Gujral and I will be answering these questions. As we all know, Q1 has been the lockdown quarter for various reasons. First is, because the first month April itself was under full lockdown. And then in May and June, partial opening started, different states had different protocols. We work in a industry with a very diversified supply chain, not only in India but also dependent globally. So there were a lot of challenges to get the production back to start mode, caused by this sudden lockdown. We are very happy to share that we were amongst the first companies to restart the operation on a single shift basis, around 2nd of May. A

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week prior to that we had started opening up the plant, cleaning and sanitizing and implementing all the new requirements to run the plant. And we did face challenges, both from our supply chain as well as from our customer side. Some of the customer plants opened much later.

So Q1 all in all was a bad quarter not only for OEM but also for aftermarket, because there was a similar issue at dealerships, there was a similar issue at service stations and so on and so forth. But the good news is that as we have managed to overcome all these challenges in Q1, it did give us a lot of time to sit back and reflect on what really we need to do as a company to manage ourselves in the new normal. A lot of focus went in during these lockdown months to have a very deep down analysis of all our cost parameters, whether they are variable, whether they are fixed. We had proactively started some fixed cost rationalization towards the last quarter of FY '20. And we only pushed it forward and took this crisis as an opportunity to right size our cost structure to bring our breakeven points down.

In Q2, we are seeing three different trends. The first trend is that everyone is better than one because Q1 was anyway a disaster. The second trend is that aftermarket is coming back much more strongly than was envisaged, rightly so because new trucks are not yet getting sold, and the existing fleet is the one which is running. And in the first quarter there was a lockdown, so a lot of these repairs and things like that also got postponed. So, as we talk in August, from August onwards we are very happy to share that our order position in aftermarket is back to pre-COVID levels. OE industry started picking up in Q2 and we expect from Q3, if not from September, that on a year-on-year basis the drop will not be there. Those of us who track this industry would appreciate that Q2 and Q3 last year were not very good quarters for the industry because they were destocking for BS-VI. So, there is a low base advantage which we have in Q2, Q3, as well as Q4. But in Q1, we all know the industry was down by around (~90%). So on the demand side, we expect in Q2 to be around 75%, 80% of pre-COVID levels on the whole. Going forward, in Q3 onwards we expect it to be better than last year in terms of demand side.

The third important thing is that we have to gear up to meet the demand. Like I shared, we are in a ramp up mode, we started with one shift, we have now shifted back to two shifts from last month. All the supply chain bottlenecks also similarly have been overcome. There was this issue of migrant labour with some of the suppliers who had gone back in the lockdown, most of it is now coming back as the country unlocks. So, from Q3 we are expecting that our production would be back to a level of Rs. 50 crores a month, which is what our FY '19 turnover of around Rs. 620 crores we had achieved. So, that is what the outlook on the demand is.

There are some promised government demand boosters which are still in the pipeline. We have been talking a lot of this. So, I am not going to mention them separately, but there is talk of GST reduction and scrappage policy. If and when they happen, they will only add to the demand. And whatever we have talked earlier is not assuming this, so this will be a added bonus for the government to decide to support the industry.

On fixed cost saving, we have had a very deep cut on all our fixed costs. Some of it would start getting reflected already in our Q1 results, if you would have seen. And as the year progresses, you will see the impact of this because this is progressing on a month-to-month basis. And FY '22 would be the first year when you will have the full year impact of the fixed cost savings which we have done.

The last question was on diversification. So the cyclical nature of the industry, plus this pandemic crisis has also made us look more closely at other opportunities. We are very happy to share that what we had started on farm tractor development is now progressing at a very fast pace with our prospective customers showing keen interest to induct us as a second source. On our subsidiary, Lava Cast, we have had a very positive impact of the pandemic, and that is one of the benefits if we were to count the few benefits of the pandemic. There is a sense which is clearly seen in European and American customers to move out of China and have a second source for castings, and we have been literally flooded during the lockdown with RFQs which total to almost 50% of the capacity of the foundry itself. Not all of them will fructify into business, but on a very conservative basis, we expect long-term business of between 5,000 metric tonnes to 8000 metric tonnes a year into exports, which will again help us derisk the cyclicity of the local market.

Having said this, we know the commercial vehicle industry has bottomed out. And therefore, we are now maybe a quarter or two away, at best, for a visible growth to start manifesting as far as the OE medium and heavy commercial vehicle industry itself is concerned. So, I hope that answers your questions.

- Moderator:** Thank you. The next question is from the line of the Dipali Bansal, an investor. Please go ahead.
- Dipali Bansal:** Sir, I have a few questions. My first question is, what would be the status on the operating margins with the decreased sales? And how much has the company penetrated in the tractor segment exactly? And how much sales are we expecting from that?
- Jatinder S. Gujral:** So, as you can see from our Q1 results, at the contribution level we have maintained the contribution. Obviously, with the turnover being lower, whether we look at FY '20 or FY '21 first quarter, data levels will come down. But as we get back on getting the top-line, the margins will improve, because we just shared that we have done a restructuring or fixed cost, so that will reflect in higher EBITDA margins once we are back to, let's say, activity levels of Rs. 50 crores per month.
- Dipali Bansal:** Okay. And how much have you penetrated in the tractor segment, sir?
- Jatinder S. Gujral:** See, tractor segment, we have been working on this. It's a long qualification process, because there are different seasons and so on and so forth. In between, one year we all know tractor segment also went down and therefore there was a little bit of go slow from the customer's side.

But what we are very happy to share is, along with the RFQs for the castings, the only bells or only phones which were ringing during the Corona crisis lockdown were from prospective tractor OEMs. So they were sensing a rise in the industry in line with the rural income. We have seen the GDP breakup also that the rural economy is holding up very well, crops have been good, monsoons have been good. So, right now, we are talking to two manufacturers and we expect supplies to start within the third quarter.

Dipali Bansal:

I have another question. Sir, you mentioned about Lava Cast, you said there have been some positive effects due to the COVID situation. Can you mention what positive effects did actually occur on Lava Cast?

Jatinder S. Gujral:

See, on Lava Cast, like I said, there is a distinct move to derisk China sourcing by the European and US customers, who buy a lot of castings from China. So, we have been flooded with RFQs from all the major Tier-1 system suppliers and the total RFQs which we have got are around 15,000 metric tonnes a year. And like I said, not all of them will materialize but we are very happy to share that we have closed commercials with one major supplier for a business of around 5,000 metric tonne per annum. And this is at 30% share of business once we start supplying, and once they are satisfied with our performance this can only go up, because normally when a second source is indicated, typically you will give 25% 30% share to that source to start with. And then based on performance, you will tend to have a 50:50 share of business. Similarly, with others, there are a lot of discussions which are progressing despite the COVID. The only issue which is coming today for a faster ramp up in this is just the physical inability to travel and do audits. Some of these companies, for example, have not started travel at all, so maybe it will take a quarter more for them to start that. But most of these companies have India offices also, so maybe they will finally make a policy where they will say we will delegate the audit to the Indian operations and avoid the travel altogether. And of course, this is foreign exchange and of course the pricing etc. is better than domestic, so it adds to our mix also. Plus, it helps us manage the cyclicity.

Dipali Bansal:

Okay. Another question, if I may ask, sir. What are the capacity utilization levels right now? As you said that from quarter three we will be back to approximately Rs. 50 crores a month, what is the current situation?

Jatinder S. Gujral:

See, in Setco, our capacity on a value basis around Rs. 800 crores, with the improved mix post BS-VI where we are selling higher size clutches where the unit price and margins are better, this would easily go up to Rs. 850 crores to Rs. 900 crores. This is our existing capacity for which all the CAPEXs, etc., have been done in the prior years. We are only waiting for the demand to come. And as and when the demand comes, we are ready to service it. Whatever we had to go through in terms of slow ramp up post the lockdown, that is also behind us. And therefore, at Rs. 50 crores we are at around 70%, 75% capacity utilization. As far as Lava Cast is concerned, our capacity is 25,000 metric tonne. The captive requirement for this level of activity would be

around 20,000 metric tonnes. And we have a couple of strategic non-captive sources also. So we can deploy around 10,000 metric tonnes to non-Setco customers, or that is our plan.

Moderator: Thank you. The next question is from the line of Sandeep Pandey from MoneyGram Financial Services. Please go ahead.

Sandeep Pande: Sir, just wanted to understand your overall aftermarket service, the business contribution in overall business in the last couple of years, how the trend is going on? And what is the future for that business? And a couple of questions are there, I will ask you one by one.

Jatinder S. Gujral: See, on the aftermarket business, the trend has been that every year aftermarket has been growing at a faster pace than OE. Even in FY '19, aftermarket was more than OE business when OE was at its peak. So even at the high point of the OE cycle, aftermarket business was about 55%. But if you look at last year or if you look at this year, this year is going to be more like 70% because aftermarket is servicing vehicles which are already sold, and OE is servicing vehicles which are to be produced to be sold. So there is a fundamental difference. The demand sensitivity just varies with the economic activity, but in new vehicles it is amplified a lot, the older vehicles have to run so they will still consume spare parts. So, when economic activity is good the market grows at around 15%, 20%, when you have a bad year like last year the market may contract only by 10%, unlike OE which contracts by 50%. So, currently OE is only 8% in the first quarter if you see, and aftermarket is more than 80%. But on a full year basis, we expect this year aftermarket to be around 70% of our turnover.

Sandeep Pande: And what is the margin difference compared with OEM?

Jatinder S. Gujral: So, the margin in aftermarket is at least on a net basis averaged out around 8%, 9% higher than what we realize in OE. We have two sets of segments in this what we sell to the aftermarket of OE customers and what we sell directly in our own brand. In our own brand the margins are still higher. And what we sell to OE, we typically get 5% to 6% more, in our own brand we get around 15% more. So, it averages out based on the turnover to around 7%, 8%.

Sandeep Pande: Okay. Sir, I see your interest cost is going up continuously for the last three, four years, Rs. 50 crores has become now almost Rs. 60 crores, you are getting Rs. 15 crore per quarter. So, what is the status on that, I mean, how you are looking to reduce this interest cost? Because it is taking almost 60% to 70% of EBITDA every year.

Jatinder S. Gujral: Yes. I think the interest cost has to be seen in line with the investments we had done to meet our strategic requirements, whether they are in Lava Cast or whether they are in-house on the diaphragm plant. We also put a very modern press facility with progressive tooling for taking care of our assembly requirements. It's a highly automated line with very little manpower and high speed line. Now, most of these investments, in hindsight we can all say, perhaps we would have deferred it by a year and had lower interest cost. But believe me, when the investments

were made, there was a waiting period for CAPEX. So, we were fighting with the CAPEX suppliers to give us early deliveries. And then once you have fired the bullet of the CAPEX and the downturn starts, you have anyway paid 50%, 60%, 70%, it makes no sense to keep delaying it, better to spend the balance 30% and install it. And then as the upcycle comes, the earnings would take care of the interest costs traditionally which have come easily. Right now it looks a bit stretched because the top-line has deflated, had the top-line not deflated it would have been like routine.

Sandeep Pande:

But still, what will it be after two year down the line comparatively?

Jatinder S. Gujral:

So two years, like we just shared up to Rs. 850 crores, Rs. 900 crores there is no major CAPEX. So as our turnover grows from last year Rs. 450 crores to almost 2x, everything is available to take care of interest cost, we can even go for early payment of loans etc., cash flows permitting. What has happened is that we have timed the CAPEX and then the market has come down, so it's been kind of a double impact that you started off the repayment of the CAPEX at the time when the industry was coming down. But now that is behind us.

Sandeep Pande:

Okay. Sir, what is the status of that total debt position as of June end?

Jatinder S. Gujral:

Total what?

Sandeep Pande:

Net debt, gross debt including.

Harish Sheth:

Adding to what Mr. Gujral said on the debt side, see, in 2018-2019 when we had got Rs. 630 crores awe were under a lot of pressure from OEs for increasing the capacity as they had envisaged a growth. Also, we were falling short in our business supplies to IM, because of the tremendous growth. So we planned certain investments and all that and we said we will take it to the level of at least increase by maybe about 30% over 2018-2019 capacity. So that capacity has been felt now, unfortunately business when down. And as Gujral said, the interest income is nothing when you compare to the overall EBITDA margin of the company. And at Rs. 800 crores, Rs. 900 crores it will be a small percentage comparatively of EBITDA, maybe it's about 15%, 20% going forward. That has not happened, so today in absolute terms interest looks like a very large amount. Once we start moving into the positive direction, some of the loans would have been repaid in two years' time, so the banks also and normal repayment, so the loans will come down, company's profitability allowed liquidity.

Sandeep Pande:

Got your point, but I haven't got the total debt amount. Roughly debt amount as of June.

Harish Sheth:

As of June, the total debt was around Rs. 290 crores.

Sandeep Pande:

This is standalone or consol basis?

Harish Sheth:

Standalone. And consol it was around Rs. 430 crores.

- Jatinder S. Gujral:** But just to give you a sense, consistently our contribution levels are around 27%. Assuming that they don't increase on a conservative basis, Rs. 100 crores increase in top-line above our breakeven will mean Rs. 27 crores flows into EBITDA. And therefore, at Rs. 600 crores we straightaway get almost 2x the current interest coverage. That's the rough max.
- Sandeep Pande:** Okay. And sir, the last one about this pledge percentage of your promoters holding, it has been quite increasingly every quarter last two and a half years. So how do you see this to come down?
- Harish Sheth:** What has happened is we have not borrowed any money in last two years at the promoter level. But unfortunately, because the share prices went down for a period of last two years it has been commercial vehicle industry and then the business and then investment in a small cap fund, SEBI's guidelines in the earlier time not allowing mutual fund to invest. Giving all the things the prices went down, so we had to cover. And that's the reason promoters pledging went on increasing. I think we expect sooner now with the business stabilizing that part will again start coming down. In another year or so, it would be back to what it used to be at 2018 level, which was about 30%, 35%. Something like that could happen.
- Sandeep Pande:** Okay. Two years down the line?
- Harish Sheth:** Over a period of two years as the market starts improving, there's only one way. And also at promoter level we also are working on some of the thought processes whereby money would be raised. So that would also bring down the pledging. So there are combinations we are working on, right time to come into the industry. We haven't applied or finalized anything yet.
- Sandeep Pande:** Anything from the open market promoters are investing, anything is possible in the next couple of quarters?
- Harish Sheth:** In the next couple of quarters, at the moment no, because markets are bad. Let the markets stabilize, under COVID nobody knows, because right now the ups and downs are so much.
- Sandeep Pande:** Since you said Q3 you will be hitting Rs. 50 crores per quarter, right?
- Harish Sheth:** Yes, company will do well, but that doesn't mean that how the investors such as you will translate that into the demand of the company, we don't know that. But yes, earnings per share, the EBITDA would be very good going forward in the coming years.
- Sandeep Pande:** One more last thing, sir, it is a little bit of the first question only. You will be focusing more on the aftermarket or on the OEM side, since 55% will become 70%, so it means the focus will be more on the aftermarket side, and as such on the industry wise also, right?
- Jatinder S. Gujral:** It is actually related to the demand we have, number one. Number two, we are very happy to share that all our BS-VI migration has happened very, very successfully. Initial results of the products, etc., which have been put in the market are exceeding our as well as our customers'

expectations. These clutches are also larger size clutches, so obviously the realization and margins go up. But the fundamental thing remains that for a clutch to get sold for OE, a truck has to be produced. What we don't control is how many of these trucks get produced. However, our policy always is to service OE demand 100%. And that is the reason why over the last 10, 15 years you would have seen consistently we have grown OE share. And for the last 10 years, we still command around 85% of the total OE market, consistently for last 10 years. So, there is no such strategy to move away from OE. It is just that aftermarket is more stable, there is more demand at the moment from aftermarket and therefore the ratio is more trucks are there, and therefore the ratio is getting skewed. But if OE were to hit the peak cycle, it will go back to 40%, what it was in FY '18, '19.

Sandeep Pande:

Okay. Sir, any new order you have recently got or not on the OE side?

Harish Sheth:

I think when you are at 85%, you are happy to maintain that share, and that has been our strategy. But around five years back we were not supplying to a couple of manufacturers of trucks, we have put a strategy in place and we added customers like MAN which subsequently closed down, we added Mahindra & Mahindra, all of them still continue to buy for us. For example, MAN is still buying for us for aftermarket, and Mahindra is buying from us for both OE as well as aftermarket. So we have all the customers doing supply. There is little headroom to grow. On the OE side, the OE diversification is more into farm tractors, because that is a segment which we are not there.

Moderator:

Thank you. The next question is from the line of Apoorva Mehta from AM Investments. Please go ahead.

Apoorva Mehta:

Sir, just wanted to ask on the export front where we were targeting the US aftermarket sales. And we were very gung-ho once upon a time that we should do very well over there. Any update on that?

Harish Sheth:

Yes. See, we still are extremely gung-ho about the clutch export. I have talked about Lava Cast, which was not in focus but now we see a big opportunity on the castings front, so I will not be repeating that. As far as the clutch exports is concerned, there is a fundamental difference that clutches in US, for example, were never imported from China or any other country, they were manufactured in US. So, the strategy there was to have a full range which we have worked on. We have tested the product; we have seeded the market. And we are at various stages of discussions with the major distribution houses there. Many of them have tried our products, come back with very positive reviews. It's just that we are not able to formalize an agreement so far. The moment that agreement happens, we will have a full distribution available to us from day one. Whatever we are selling in our own brand continues to give us repeat sales. So the product acceptance is not a problem, but getting a tie-up done with one of the major players in the market there is, I think, what is the last step which is left. Next two, three quarters hopefully we should be sharing further developments on this.

- Apoorva Mehta:** And can you throw some light on the breakeven of Lava Cast, at what capacity utilization we should breakeven and are we making that the breakeven comes down, we have done some cost cutting and everything, so are we seeing that the breakeven point has come down and we should do recent breakeven?
- Jatinder S. Gujral:** So I think we have worked in the last two years to stabilize the operations of the foundry, which is reflected that despite the capacity utilization coming down substantially last year to almost 50%, our losses or EBITDA did not move in the same direction, the balance being the improvement. Now, we have also ensured that, for example, our fixed costs are down to 2017-2018 levels now, so there also we have done this. With all this, at around 60% we start breaking even in the foundry.
- Apoorva Mehta:** Okay. So, this new order which you are talking about, when it will start, I mean, when are we going to start production and when can we see some numbers coming from that?
- Harish Sheth:** It will take a couple of quarters.
- Apoorva Mehta:** So by this maybe January?
- Harish Sheth:** End of FY '21, yes. FY'21 last quarter maybe we should be doing the first shipment. A little bit of it, like I said, is also dependent on whether they wave of the visit of the European team to audit our plant and delegate it to the Indian team. Normally they are reluctant to do this because the buyer feels that unless I see the plant I am responsible back home. But all this mindsets were before the Corona. So I am sure they would also be thinking how long we can wait, you know. So, I don't think they are going to wait for next two years, for example, if travel is not allowed, they will find a way.
- Apoorva Mehta:** So we can see from Q1 of next year the sales picking up?
- Harish Sheth:** Lava Cast, definitely. Lava Cast will be better this year compared to last year based on Setco's own this thing. But if your question is more from an export business perspective, yes.
- Apoorva Mehta:** And sir on the clutch side, we were talking about tractors also. So we were talking about tractor from a long period of time and we were expecting some good orders and traction from the big tractor companies. But why it has not materialized, any thoughts on that?
- Harish Sheth:** No, I think in 2018-2019 there was good traction from OEMs, but we were in that period falling short of capacity. In 2019-2020 the tractor industry went through a downturn, so while we were keen, the customers were a bit slow. Now, in the last two years we have put our capacity, etc., issues behind, like what we have shared. So now there is a positive traction from their end, and we are equally keen to fructify this relationship. And testing is a year and a half, two years more than, unlike a truck which runs regularly around the year in the same duty cycle what it is, a tipper will be a tipper for 12 months. In tractors, the applications on which the tractor runs are

different. So if you miss a season of testing, it probably waits for another one year for the season to come back. So, that has been also one of the reason which caused these delays. But now most of these testing issues are over with the two customers with whom we are in active engagement. So once they start, then others will also get more confidence. The tractor industry is a bit different, the testing protocols are more linked to who else is buying rather than what is my, unlike cars or CV where each company does its own testing. So getting the first couple of customers is always more difficult in the farm tractor industry. Once you are in with couple of them, then others will tend to accept your own validation and move ahead.

Apoorva Mehta:

What is the opportunity size if we can just think of that, what will be our opportunity size in tractor industry?

Harish Sheth:

So, in three years we expect the business to be anywhere between Rs. 50 crores minimum to as high as Rs. 75 crores in OE alone, and then there is aftermarket, etc., which happens once OE happens. So, it's going to be a sizable part of our OE business, because roughly if you see, the tractor market is around 700,000 and the average cost of this clutch is around Rs. 6,000, and these dual double clutches currently the adoption rate is varying between 20% to 35%, depending on the manufacturer, but it is going up. So it's a growing market where more number of tractors being produced are using these clutches and we would be the second source. So from the customer side also there is traction, because if they have to put this clutch on more models they need the surety of supplies, which with the two source becomes more assured from their perspective. And once a manufacturer were to put it on a range of tractors in which others are not putting it, then the others are under pressure because they start losing market share because they don't have this feature. So then it spreads fast. Not as fast as Coronavirus, but it's a little bit viral there.

Apoorva Mehta:

Sir, and another thing is that what is the value addition from BS-IV to BS-VI if you want to ballpark it, what kind of value addition you have seen in the OE clutch division?

Harish Sheth:

So, what has happened fundamentally is that the major portion of M&HCV because of this 25% axel norms, etc. also coming in, the horsepower has been upped. Typically 180 horsepower engines were there in BS-IV, they have moved up to 210 to 230 horsepower. And I am talking of Indian major manufacturers, right. So, these manufacturers then have to use a bigger clutch to manage it. The bigger clutch is anywhere between 15% to 30% higher in price, okay? Now, the second issue is, because there is more material content and obviously our unit margins are also higher, percentage may be same. The other issue is that some of these customers when they were making their engine BS-VI, there was a specific requirement in certain model gearbox combinations to do a certain dampening, which was an added engineering solution which we had to give. So, for that we have added around \$4, \$5 per clutch, out of which 50% would be margin. But these are specific for certain specific gearbox engine combinations.

Apoorva Mehta:

So more or less ballpark it would be roughly around 15%, 20%.

- Harish Sheth:** 20% is a safe number.
- Apoorva Mehta:** So whenever we go to the peak level again when we were there, so we can assume that 20% turnover will directly come from the value addition factor?
- Harish Sheth:** Yes, that is why we said our original capacity of 800 at the old mix, now goes to 900 at the new mix. Because OE in the initial years will be taking this 20%, but as we move forward over the next two, three, four years, a lot of this will also reflect in aftermarket demand when it comes up for replacement. So, in the long run, this 20% will be there in all segments, first two, three years primarily in the OE segment, and then also in the aftermarket segment.
- Apoorva Mehta:** Sir, last question. We were also in talks with supplying casting to OEs which were like telco or other players. So, is there any breakthrough in that, because that was one of the key things which were going to do?
- Harish Sheth:** Yes, there was a very good breakthrough. We got approval from both Tata Motors and Ashok Leyland. But unfortunately, when we got the approvals the market started moving down. We were not the first source, so when their own demand shrunk by 50%, as per their policy, they will first try and protect their existing sources before really starting buying from us. So, it kind of came in at a time when the market was going down. In a way it's also a learning for us that if we are supplying clutches to Tata and if we are supplying castings too, when you are going up both go up, and when you come down both come down. So, that is why we are looking at exports as a more sustainable option to derisk the business.
- Apoorva Mehta:** So, broadly Lava Cast this year can we reach around 50%, 60% of our turnover or no?
- Harish Sheth:** Yes, we should be hitting around 12,000 plus tonnes, which is around 50% of the capacity.
- Apoorva Mehta:** Okay. So can we breakeven in Lava Cast, or 50%?
- Harish Sheth:** Next year EBITDA will be positive, breakeven will happen I think maybe in quarter four, but not on the whole year basis. First quarter, etc. has been bad.
- Apoorva Mehta:** Okay. And on the clutch side, on the normal Setco side standalone, should Q2 be breakeven on standalone level?
- Harish Sheth:** Yes, I think on a standalone basis we should not be making losses Q2 onwards.
- Moderator:** Thank you. The next question is from the line of Jaimin Desai from ICICI Direct. Please go ahead.
- Jaimin Desai:** Firstly, in respect of TransStadia, could you tell us what the performance was like for the company for FY '20? And have the accumulated losses reduced there?

- Harish Sheth:** You see, we are discussing right now Setco Auto. TransStadia is a completely separate company. We wouldn't have those any of the figures over here. And it's a different topic altogether. So I would request you not to discuss TransStadia on Setco Auto. We can discuss Lava, we can discuss Setco Auto as much in detail as you like. And Setco Auto is not a major investor in TransStadia, it has very little investment which was done more than five years back, and it's not putting in any more money inside at all since last few years. So really, it doesn't affect Setco Auto in any way.
- Jaimin Desai:** Sure. But would our investment in to TransStadia remain going ahead? I mean, would you be writing down our investments? Are there any such plans there?
- Harish Sheth:** Investment has been very small, hardly Rs. 10 crores, and I don't see any reason why it will have to be written-off in the coming years.
- Jatinder S. Gujral:** Whatever initial investment was done; we would be following the accounting standards. And any impairment or whatever has to be taken in due course we will look at it. Right now we don't really envisage. And materially also it's not a major event at all.
- Jaimin Desai:** Alright. Secondly, in respect of Lava Cast, by when can we tentatively expect a decision in respect of the restructuring proposal from the lenders? Have you received any feedback recently from them?
- Harish Sheth:** We expect this in the next 30 to 45 days' time, that's an estimate that has been given to us, the restructuring proposal. It's on a final stage.
- Jaimin Desai:** Alright. And the company is firm that there will be no liability accruing to us in respect of Lava Cast, right?
- Harish Sheth:** Liability in what way, if I may ask?
- Jaimin Desai:** So, in the press release you have mentioned an amount of Rs. 116-odd crores.
- Harish Sheth:** Yes, that notice that had come, that is being withdrawn with the restructuring, so Setco will have no liability, no. That notice is getting withdrawn.
- Moderator:** Thank you. The next question is from the line of Dipali Bansal, an investor. Please go ahead.
- Dipali Bansal:** Sir, as you just mentioned that the average cost of clutch in tractors is approximately Rs. 6,000, do you have any current per unit realization for the OEMs as well?
- Harish Sheth:** So like I shared, we expect this business to start towards Q3 end. But pricing, etc., which we have settled is fixed.



*Setco Automotive Limited
September 14, 2020*

Moderator: Thank you. As there are no further questions, I now turn the conference over to Mr. JS Gujral, CEO of Setco Automotive, for his closing comments.

Jatinder S. Gujral: Thank you all for taking time out to attend this investor conference. We, like a lot of us, have gone through a bad period in the last three quarters. And as we talked today, we are very confident that the worst is behind us. And in fact, it has given us a good opportunity to deep dive internally and see how cost can be saved. So the crisis really has been an eye opener in many ways. We have also put in a lot of improvements at the plant level on productivity, cost, so on and so forth. And as the economy comes back, which it will, it's only a matter of time, we are well positioned to exploit the upside. I would also request if some of you are interested, of course, following the travel protocol, etc., which the company or as individually you follow, to visit our facilities. You can let us know, we can always organize a visit to the plant. Thank you.

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