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SETCO™
AUTOMOTIVE LTD
LIPE CLUTCH

August 25, 2016

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 enclose the transcript of the Conference Call hosted by the Company on August 17, 2016 at 4:30p.m (IST).

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

SETCO AUTOMOTIVE LTD. MUMBAI

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Company Secretary

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Setco Automotive Limited
Conference Call
August 17, 2016

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Setco Automotive 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 any assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. I would now like to hand the conference over to Mr. Vinay Shahane. Thank you and over to you, sir.

Vinay Shahane: Thanks. Good evening, Ladies and Gentlemen. Welcome to this conference call analyzing the first quarter results of the Company. I have with me Mr. Udit Seth, our Joint Managing Director and we will discuss with you the analysis of first quarter results as well as the outlook for the year and beyond.

The first quarter top-line, as is already shared on the presentation, grew by around 10%, driving mainly on the growth in OEM segment. But more important than the top-line growth is that the operating efficiency and the profitability improvement which we witnessed in the second half of last year has continued and EBITDA for the quarter year-on-year has increased by around 250 basis points, and that augurs well for the organization going forward as the volumes pickup. As a result, the operating profit before tax excluding other income has also grown up four times to Rs. 4 crores against Rs. 77 lakhs in the previous quarter in June 2015.

These are the broad highlights of the performance. And I would now like to throw the conference open for any questions and discussions. Thank you.

Moderator: Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Deep Shah from SBI Cap Securities. Please go ahead.

Deep Shah: A couple of questions to start with. Sir, in the previous conference call you have mentioned that you are targeting Rs. 1,000 crores in the top-line, I mean, can you just share more lights how are you planning to achieve these numbers?

And the second is, what is your outlook on CV industry in India?

Udit Seth: So, I think we are quite well poised with our numbers to achieve Rs. 1,000 crores, core contributors towards that financials are, number one is our entry into the farm equipment segment, we have participated in a number of RFQs and we believe that the product will be ready to roll out towards the last quarter of this financial year. The other contributor is the exports business where we believe that both North America and Russia and Middle East will be markets which will be continuing to take our products. And lastly, the consolidation of our foundry business into the numbers. So, I think cumulatively put together we are confident of achieving our said target.

To add to that, on the CV industry outlook side, I think in India we see an up-cycle, currently over the next two to three years I think that will be contributed on the back of three specific reforms, one is the emission standards are changing and therefore new trucks will ply on the roads with different power to weight ratios, which means that larger clutches with better returns will be used in those vehicles. The other areas we also see growth coming from is, we are witnessing pick-up in infrastructure and construction and mining, so that is where vehicles would go. The only difference I see is that because of the sudden shut down of the mining sector some of the fleets will buy more versatile trucks so that if for another reason some sledgehammer comes down in the future, those trucks can be deployed rather than just sitting idle. But we do see after next three years to be quite good and the replacement market will continue growing for us as well because we are the clutch of choice at the OEM level, so in the first three ownership cycles we believe we will be the choice for replacement and replacement growth will start coming from the second half of this year.

Deep Shah: Sir, I have one more question on CV outlook itself. Have you heard anything from the CV side, given that the first two months of the year has been quite muted as far as the growth is concerned? So have you heard any revised production outlook from the CV end off late?

Vinay Shahane: See, generally in the first quarter the growth CV industry has recorded is quite decent on an expected lines and as well as in-line with the yearly guidance what they had given. The second quarter, which is the monsoon period, generally sees a little downward trend, of course, it is not a decline but the growth is at a little low rate is a general phenomena every year. And okay, second quarter is in-line with those expectations but moving on yearly basis we still believe the yearly guidance what the OE players had given still hold good.

Deep Shah: Sir, basically there are no cuts in the production.

Vinay Shahane: At present no, whatever is there is what is on expected lines and normal business cycles, nothing to worry.

Moderator: Thank you. Our next question is from the line of Paras Adenwala from Capital Portfolio Advisors. Please go ahead.

Paras Adenwala: I am just looking at your numbers and trying to compare these numbers with other vendors like you who supply essentially to MHCVs. And looks like the numbers that you have reported are slightly lower. I fully understand that 54% of your sales has de-grown in the first quarter, it is only the 46% that is giving you this 10% growth. So, but even qualitatively if I see the numbers, some other guys have reported significantly better numbers. So, would you want to comment on that, please?

Vinay Shahane: Well, there are a couple of things. As you rightly said, the business mix for the Company is balanced in favor of OEM as well as aftermarket, and as you rightly said, the growth in the first quarter is driven by the OEM growth and aftermarket has been more or less flat for the quarter. The other players, I do not know, since you did not mention the names. Very few companies have a balanced mix or diverse business mix like OEM and aftermarket, more are predominantly either OEM or predominantly aftermarket. So who are really dependent on OEM business, naturally the growth for them would be higher in line with the OE industry growth. So the top-line growth we will say, yes, perhaps our average growth may be little lower than the OE growth. But what is important you have to look at is the profitability as a percentage which is really a barometer of performance which has improved by almost 250 basis points over last quarter and that is of very significance because that shows a fundamental shift in the profitability and efficiency of the organization. And as the volumes pick up, as they are bound to, it will further multiply and show better results.

Paras Adenwala: But aren't your operating margins slightly on a lower side, considering the fact that aftermarket is supposed to be more profitable than OEM and you have more than half of your sales coming in from aftermarket?

Vinay Shahane: Right. But if you compare the segment wise mix of aftermarket, it is slightly lower in this quarter than what has been last year. Last year on an annualized basis if you look, aftermarket was around 60% which has gone to around 54% this quarter. So naturally that segment mix, OEM getting higher share of business is naturally going to bring down the weighted average operating margins at the company level.

Paras Adenwala: If I may ask, what is the difference in operating margins between direct OEM sales and aftermarket?

Vinay Shahane: See, direct OEM, if my pricing is say Rs. 100, my aftermarket pricing through OES channels would be around Rs. 107 to Rs. 109, but in percentage terms, profitability of margin percentage, it is almost double if you look at it. And independent aftermarket is slightly further higher realization at around 5%. So, the more I increase the composition of aftermarket to my sales it will automatically improve the margins further upwards.

Paras Adenwala: So this percentage of 51%, you see that improving in the second half as you mentioned?

Vinay Shahane: Yes it will be, it will. Like, what we have given in the performance note, the OES aftermarket because of the downturn in OE segment in FY13 and FY14, the first replacement cycle vehicles will be just coming to the market and should be in the second half we should see that upward movement in the OES sales also.

Paras Adenwala: So this cycle of two, two and a half years, is that a thumb rule or do you already have indications?

Vinay Shahane: It is of empirical evidence as it is shown in those figures.

Paras Adenwala: For the full year your plans for growth are absolutely intact and there is no change in that?

Vinay Shahane: Yearly we are looking at a decent growth in top-line as well as bottom-line.

Paras Adenwala: And on the financials, your interest burden seems to be high, your interest cover is just about 2x to 2.5x. And I was looking at six to seven years back when your interest cover was really good at about close to 5x and over, so do you see that kind of interest cover coming back or you will always be around 2.5x to 3x?

Vinay Shahane: No, it will improve over the period,. whatever has happened is simple accounting treatment what you give to the subsidiaries that we have established in UK and USA, the interest income from them is displayed as other income, it is not netted from the interest cost in the financials. So basically, one has to look at the interest cost on a net basis rather than on a gross basis as is displayed in financials. So that is basically one reason and the company has been continuously investing in CAPEX year-on-year irrespective of the market conditions looking at what will be, say, one year hence market requirement and we are investing continuously on CAPEX including on product development, research and development facilities so that interest on that fixed element, term loans, will continue to be there. As the profitability improves, yes, perhaps we can look at leveraging the capital structure and finance the CAPEX through internal accruals to improve the interest coverage.

Paras Adenwala: So we expect the debt equity to be about 1x to 1.5x?

Vinay Shahane: It is on a standalone basis, my debt equity in March is just around 1, 1.1. And it will improve, it will not deteriorate.

Paras Adenwala: And your other income has reduced very significantly, so…?

Vinay Shahane: Yes, that was basically the foreign exchange fluctuation gain during the last year in June 2015, it was almost around Rs. 3 crores. Against that we have this year add to account Rs. 1 crores loss in the first quarter, basically, on account of Sterling Pound. So that is, basically, a book adjustment on a cut-off date when new accounts are prepared, so these are either income or expenses basically a notional entry which evens out over period of time.

Paras Adenwala: And finally, what is your capacity utilization like right now?

Vinay Shahane: It is around 65% to 70% at present.

Paras Adenwala: And optimally it can go up to what levels?

Vinay Shahane: Optimally it can go theoretically up to 85% - 90%.

Paras Adenwala: Because you have said that you have to keep on incurring capital expenditure.

Vinay Shahane: Yes, that is why 85% - 90% is the optimal level. But as I said, we generally are ready one year in advance of our market expectations and have to be ready both physically and machine wise, everything.

Moderator: Thank you. We have the next question from the line of Mahesh Bendre from Way2Wealth Securities. Please go ahead.

Mahesh Bendre: Sir, our foundry project has commenced in April 2016, so how has been the progress and over the next nine to 12 months how this will become fully operational?

Vinay Shahane: Yes, you rightly mentioned that the foundry project has gone commercial in April 2016 and has started supplying to Setco currently. The unit is getting the TS [Quality] certification during this month and we are working on various avenues for the external business and in talks with various OEs for their casting requirements. But, that is a long drawn process which will take anywhere between two to four months to get the projects done and components and fixtures developed for that requirement. So maybe the external business will start somewhere in the second half more towards the end of third quarter, but really will pickup in FY17 - FY18. Till then the foundry will continue of course to supply to Setco for its requirements.

Mahesh Bendre: So, initial capacity is 30,000 tons, so are you implying that last quarter could be the quarter where there could be full utilization?

Vinay Shahane: Not really, full utilization, FY18-FY19 will see the full utilization.

Mahesh Bendre: And sir, for the full year, I mean, in the first quarter we are growing 10% in terms of sales. So what is the outlook for rest of the year and, if possibly, for FY18 in terms of growth?

Vinay Shahane: Top-line, the way the things are moving and the way we are getting the indication from customers and market, we expect top-line growth anywhere between 20% - 25% during the current year. And as Udit was earlier just mentioning, the OE cycle, the CV cycle we expect to be on the growth path and tractors coming in from next financial year for the full year impact, and next year also we expect another similar growth of around 25%.

Mahesh Bendre: And margins, will there be any improvement in the margins going forward?

Vinay Shahane: Yes, margins will improve automatically. One is the product mix and second is basically the volume of operations, both will impact the margins.

Mahesh Bendre: Sir, what will be the current debt on the book, net debt?

Vinay Shahane: Net debt, from March it has not really changed, it will be around Rs. 230 crores - Rs. 240 crores on standalone basis.

Mahesh Bendre: We are not incurring a major CAPEX this year?

Vinay Shahane: It is a routine CAPEX of Rs. 15 - 20 crores on a yearly basis, what we keep on incurring, nothing substantial.

Mahesh Bendre: So, no major capacity expansion plan?

Vinay Shahane: No major capacity, the routine capacity expansion and enhancement is continuing but nothing major big ticket item.

Moderator: Thank you. Our next question is from the line of Apoorva Mehta from KSA Shares and Securities. Please go ahead.

Apoorva Mehta: Sir, wanted to know something on the export front, we have muted export this quarter, so what is your outlook for the full year export and what are our chances that we will do very good, you are expecting to grow good in US and Russia, so can you throw some light on that?

Vinay Shahane: Yes, exports this quarter also have not really performed remarkably, and not grown over the last year. As you know, the international CV market is not really going through a positive phase and that has impacted the international business. Plus, we have certain operational restructuring and revamping of operations at our foreign subsidiaries where we are controlling the operations in a more stricter way to control the ultimate cost of the operations at group level which has resulted in drop in first quarter. Looking forward, for the year at least the first target will be to achieve the levels what we achieved in FY15 of anywhere between Rs. 32 crores to Rs. 35 crores based on the existing product range and the future customers potential what we are looking at. And a couple of initiatives what we just mentioned, about the US distribution or the Russian opportunity, will further boost it that will add on to this level of operations.

Apoorva Mehta: But when can we expect for the US and Russia?

Vinay Shahane: It should be, I mean, the full year impact really in the next financial year FY18.

Apoorva Mehta: But this last quarter it will start?

Vinay Shahane: Yes, we hope to start it in second half, last quarter more particularly. But the full year impact it will gradually step up the operations, so the full year impact would be in the next financial year only.

Apoorva Mehta: Sir, currently the starting requirement from Setco is 100% from Lava?

Vinay Shahane: No, we are keeping some other vendors also open for business, around 70% - 80% is taken from Lava Cast.

Apoorva Mehta: So what is the utilization in Lava today?

Vinay Shahane: Lava, today clearly talking about utilization is perhaps out of context, because one is the business model of Lava Cast, Setco is normally going to be taking around 35% - 40% only, it is more about external business which are domestic or international. And as I was just explaining, that is a little time consuming process which will take four to six months to get the domestic business also on table and international business with our JV partner should also start materializing in the coming months. So, FY18 it will really be the year or the period when we should see the operating efficiency of Lava Cast. 2016 - 2017 will be just a learning initial curve.

Apoorva Mehta: And on the farm equipment side, we are expecting to start supplying on Q4, so what will be the margins in that, that will be similar to the margins in commercial vehicles or it will be different?

Vinay Shahane: It will be slightly lower than MHCV segment.

Apoorva Mehta: And what are we expecting to do next year, maybe, from farm equipment approximately?

Vinay Shahane: Got to be anywhere between Rs. 20 crores to Rs. 25 crores.

Apoorva Mehta: And on the aftermarket, can we have any breakup from OES and aftermarket what is…

Vinay Shahane: its two-third, one-third between the two in the long run, in a quarter or a month it could be different but if you look on an annual basis two-third will be OES and one-third will be aftermarket.

Apoorva Mehta: So, are we gaining market share in aftermarket for further gains?

Vinay Shahane: We have maintained whatever, for last financial year we have not lost anything in aftermarket, actually aftermarket is grown in first quarter year-on-year, though OE aftermarket has remained more or less flat.

Apoorva Mehta: And on the diaphragm coils spring what we have developed, have we started utilizing that?

Vinay Shahane: See, we have started utilizing certain varieties, production in springs and using it in products, but it will be a phased rollout of all varieties and in certain cases we will have to take the OEM approval before we really put it in the products.

Moderator: Thank you. Our next question is from the line of Priyank Gupta from SBI Securities. Please go ahead.

Priyank Gupta: Sir, you have already highlighted about the farm equipment sector, so what about your LCV segment, how is it shaping up?

Udit Seth: The LCV segment, we have now been nominated at the OE level for one of the product lines. LCV as such, we are not focusing on that as our core business at all, we developed it from case to case basis as and when the OEM really needs an alternate source to supply into. And it opens up the aftermarket for us. Our focus will continue to be the MHCV sector and the farm equipment sector.

Priyank Gupta: And sir, one more thing, what would be your capacity utilization in Q1 for the foundry business?

Udit Seth: Q1?

Priyank Gupta: Yes.

Udit Seth: I mean, it will be quite negligible compared to potential that is there, because we have planned close to 3,000 tons, 2,800 tons per month, this is only the ramp-up space, so we would have possibly done maybe 500 tons per month to begin out of the 2,800 tons. So, if you look at it it's not really more than 20%.

Priyank Gupta: And sir, are you holding on your guidance of around 60% capacity utilization for FY17 for the foundry business?

Udit Seth: More close to about 50%.

Priyank Gupta: And sir one bookkeeping question, sir, what would be your volume for DPs, CA in the quarter gone by?

Vinay Shahane: For the quarter…

Udit Seth: Just remember that the number is actually a mix of various sizes. So what happens is that your capacity is changed by size, but nonetheless I will tell you which ones we produce and how much, but I do not think you should be able to infer that in any particular way.

Priyank Gupta: I just require the total volume.

Vinay Shahane: The total driven clutch during the quarter was around 205,000 and your cover assemblies were around 125,000.

Moderator: Thank you. Our next question is from the line of Sushil Bhojwani from Elara Capital. Please go ahead.

Sushil Bhojwani: Like you guys have said that the focus is to kind of increase exports and you have also mentioned that it is a difficult market to tap into, so just wanted to understand how are you guys planning to explore that market, I mean, because selling to OEM directly might be a challenge for us but then there should be some kind of strategy which you guys would be working on because this market is something which you are kind of targeting?

Vinay Shahane: Yes, I agree. But see, we will be starting afresh in this market segment, the efforts in various geographies have been going on for the last couple of years with the introduction of the products required by the market. And testing the initial market seeding has been going on, ultimately the time has come when we reap the benefits of the efforts what have already been undertaken. And a little bit sentiment how the international economy has also performed, will also impact the export growth. But it will be basically aftermarket which has initially been targeted, OEM will come in due course of time.

Sushil Bhojwani: And how much do we expect to, kind of, as a percentage of top-line sell from exports in FY18?

Vinay Shahane: FY18 will have to be around 10% to 12% of the top-line.

Sushil Bhojwani: And the margins there would also be similar?

Vinay Shahane: Margins, yes, will be highest amongst the segment.

Moderator: Thank you. Our next question is from the line of Harsh Shah from Dimensional Securities. Please go ahead.

Harsh Shah: Sir, my first question is regarding this foundry business. So, what would be the gross margin currently for this foundry business and where do you see it getting settled over two, three years?

Vinay Shahane: See, currently looking at the costing when the capacity utilization is not significant will not be really the right way to judge the performance of the foundry, but anyway we are in business and so the pricing has to be at a competitive whether they are supplying to Setco or to external domestic customers and we will be competitive. So there is no issue about costing, it is just the question of stabilizing of operations at certain level and ramping up the operations.

Harsh Shah: And over a period of time, two three years when we are established players, what kind of gross margin can we look at?

Vinay Shahane: Yes, we can look at EBITDA of around 14% to 15%.

Harsh Shah: And could you guide a bit around gross margin level?

Vinay Shahane: Gross margin, see because it will be machined casting, so basically the gross margins at a customer level will be different. My correct, sorry, EBITDA will not be around 14% - 15%, it will be around 18% to 20% when fully the foundry is operational.

Harsh Shah: And other question is relating to the interest expense at consolidated level for this quarter?

Vinay Shahane: It could be around Rs. 11 crores against Rs. 7.5 crore what is reported on standalone basis.

Harsh Shah: And have we started expensing the interest on loan taken for Lava Cast or we are still capitalizing it?

Vinay Shahane: No, the interest, once the commercial production has started in April, it is getting expensed out.

Harsh Shah: Sir, what would be that component, full year of Lava Cast?

Vinay Shahane: It will be around Rs. 1 crore a month.

Harsh Shah: Sir, my next question is relating to a product that is launched by John Deere, Perma Clutch. Sir, there is making quite noise in the market, they have gone to some advance technology, so can you tell me whether it competes with us and how can it affect us, especially in the farm equipment business?

Udit Seth: We do not have knowledge on this product, because the latest RFQs that we have received are of a double clutch which we are going and developing and it is already fitted in for testing. So, from what volume gain treatment related data we have, it is a little different from this clutch that you have mentioned.

Harsh Shah: And my last question is relating to one of our related party transaction, so we have lent around Rs. 40-odd crores, we had subscribed to preference share of Setco Engineering Pvt. Ltd. around to the tune of Rs. 40-odd crores, so can we get a knowledge of where exactly is this money being used?

Vinay Shahane: See, basically, Setco Engineering is a holding company of Setco Automotive and it is a group investment company and Setco has subscribed to the preference shares for other growth ventures and specifically we had purposefully subscribed as a preference share capital bearing 9% dividend which really break-evens my interest cost whatever I have to book, with average interest cost of around 12% post tax return of 9% and that 9% return is assured. So, on a P&L really the Company does not get any hit on that account. These are preference shares so will be redeemed over a period of time, we expect some redemption during this financial year also.

Harsh Shah: How much redemption are we expecting in this year?

Vinay Shahane: It will be premature to tell but it will definitely start this year.

Harsh Shah: Because again, these are non cumulative shares, if that particular business is not able to do well we might lose out on this dividend.

Vinay Shahane: But when I am saying the redemption will start, means that gives the confidence that the business is doing the purpose, what we will get is given, so the group company is in a position to repay preference shares.

Harsh Shah: And another question is, so we have borrowed around Rs. 110 crores for Lava Cast, so that borrowing is around 12% - 13%?

Vinay Shahane: Yes, that is what I said, Rs. 1 crores monthly interest.

Harsh Shah: So, I was just wondering that why could not we lend this Rs. 40 crores to Lava Cast at 9-odd%, 9% - 10% and rather we borrow it at 12% - 13% from the market?

Vinay Shahane: See, it is a joint venture, it is a separate joint venture and when I borrow something there has to be some equity contribution, the banks will not lend Rs. 110 crores, any bank will require certain equity promoter contribution by way of equity and promoters cannot be given everything by way of loan, but will be the equity of the organization then. You cannot have zero equity and 100% debt for any project finance.

Harsh Shah: No, I am talking about the debt which we have taken, we have taken debt to the tune of Rs. 110 crores, so instead of Rs. 110 crores we could have taken lesser loan from the bank and the remaining could have been lent by Setco Automotives, this Rs. 40 crores which we have lent to the promoter entity.

Vinay Shahane: Ultimately it is giving me the return, at a group level I do not suffer whether it is right pocket or left pocket, which is the only thing.

Harsh Shah: Because here we are getting 9% dividend.

Vinay Shahane: Actually it is tax free, if I get interest of 12% I have to pay tax on that, so net this thing is 9% only.

Harsh Shah: But still we are not in the 30% tax bracket?

Vinay Shahane: The MAT is only for another one year.

Moderator: Thank you. Our next question is from the line of Prashant Biyani from JHP Securities. Please go ahead.

Prashant Biyani: For our tractor business, who are the OEMs with whom we are tying up for?

Udit Seth: We are talking to Deere, Tafe, Sonalika, these are some of the names.

Prashant Biyani: And who would be our competitor in the tractor segment?

Udit Seth: LUK**.**

Prashant Biyani: And for Q1 how much of the internal requirement of foundries was supplied by Lava Cast?

Vinay Shahane: Around 70% - 80% of Setco's requirement was supplied by Lava Cast.

Prashant Biyani: And what could be our total market share in aftermarket segment?

Vinay Shahane: In OE aftermarket I am 100%, independent aftermarket it could be around 50%.

Prashant Biyani: So for total aftermarket it could be how much?

Vinay Shahane: See, we really cannot judge a real independent aftermarket because how much comes to the branded segment or organized segment and how much is unrecognized segment is really difficult to judge as a market size to work at market percentage or market shares.

Prashant Biyani: But sir in your experience, the experience that you have in this field, in your experience how much could be the total market share for us in the independent aftermarket segment?

Vinay Shahane: Can you just clarify what exactly you want?

Prashant Biyani: I mean, for the total aftermarket segment what is our market, including OE and independent, both.

Udit Seth: See, OEM we have basically almost 90% to 95% of the market share, in OES we have 100% of the market share and independent aftermarket we have close to 50% of the market share. So, that is how it gets divided. If you look at the park size of vehicles which are completely outside today, you can take a 3.5 million kind of a number for vehicles which have age of about 12 years or so or close to maybe 3 million. But out of which maybe the last ownership cycle is not even addressable by us, so maybe 600,000 vehicles we cannot even touch or even more because they do not compare to the branded products. And so the addressable park size is about 2.2 million - 2.3 million vehicles out of which the first ownership cycle has taken care of by the OES which we only cater to. So, from the numbers that we have generated, I would say, about more than half of it is under our control, that is a part segment which will never touch.

Prashant Biyani: I joined in late in the call, so if you can just give the breakup of our sales in OE aftermarket and export?

Vinay Shahane: Yes, the OE in first quarter was around 46%, aftermarket was 51% and exports was at 3% during first quarter.

Prashant Biyani: And how much could be the realization difference for a clutch in M&HCV and for a clutch in tractor?

Udit Seth: I think your tractor clutch can be priced anywhere between Rs. 3,000 and I would say Rs. 5,000, maybe even double clutch which goes up to Rs. 6,000 - Rs. 7,000. And the OEM clutches go anywhere from Rs. 6,000 to Rs. 14,000. So it really depends on which range you are in terms of sizing, it is very difficult put some common averages down because the market is getting quite specific on power and weight.

Moderator: Thank you. Our next question is from the line of Mahesh Bendre from Way2Wealth Securities. Please go ahead.

Mahesh Bendre: Sir, my questions have been answered. Thank you.

Moderator: Thank you. Our next question is from the line of Parth Gala, individual investor. Please go ahead.

Parth Gala: Can you throw some light on the falling raw material cost and also something on the future outlook of the Company?

Udit Seth: See, we believe that from a future standpoint we are poised for growth as per the guidance we have given, we are looking this year itself at about 20% - 25% growth in top-line but the bottom-line will grow in a much more different manner every 35% - 40%. Our growth drivers, we have mentioned earlier across farm equipment and international business, those will continue to be our focus areas apart from ensuring the organic growth that happens within the M&HCV sector. On raw material pricing, Mr. Shahane will give a thought.

Vinay Shahane: See, raw material pricing, again, is a play of couple of factors. One is that commodity prices as such in isolation and also the business mix what we have, how much the OES and IAM sales constitute to the total business with varying margins, the segment mix also plays a substantial role. And, we are always on lookout as a part of business reengineering, product reengineering process looking at process improvement, reducing the rejection, scrap, etc which controls the wasteful expenditure really and which improves my material cost. So it is a effect of multiple factors, there is no single factor which will drive this and we have to be continuously on the look for this.

Parth Gala: One more question sir, can you give a breakup of the inventory we have of around Rs. 11 crores?

Vinay Shahane: Yes. See, basically this inventory pile up as you compare with March is basically in anticipation of the OE growth what we have expected and to maintain continuity of operations the monthly ups and downs have to be factored in, some months the inventory will be going up and in the peak months naturally the liquidation of inventory will take place. Secondly, also we have to remember for imports the lead time cycle is much more at around three to four months compared to domestic and so those inventories will pile up, but they are within the norms or where there are deviations we are aware of it, these are conscious decisions and we will come in line over a period of time, maybe in next one or two quarters.

Parth Gala: One last question, are you ready to dilute equity for bringing down the debt in the future?

Udit Seth: We have not really thought about that.

Moderator: Thank you. Our next question is from the line of Ketan Chaphalkar from ZephyrPlease go ahead.

Participant: My question is basically regarding, since we are focusing more on exports now so what kind of global competition do we have in terms of acquiring market share in this particular business?

Udit Seth : See, we have the product and the technology already available with us, so I do not think it is a technology acquisition requirement that we are looking at, we have all the necessary equipment for testing, all the design engineering tools and we know exactly what is required as per the different operating conditions in different markets. So, I do not see technology being a barrier at all for growth. Being OEM nominated is a big growth driver in the clutch business because normally now in the vehicles which are engineered in a much more durable manner and with emission standards controlled, people only like to replace with what is coming out of the vehicle rather than taking a risk of extended downtime or premature clutch failure due to many other consequential issues. Therefore, our entire strategy for international business for Europe remains to be OE driven and as we are nominated in their subsidiaries here in India and their global sourcing offices have taken note of us, that is a journey we have undertaken. And the American market is a bit slightly different, you can actually grow in the aftermarket business independent of the OE nominations because philosophy there is that they actually give the component level configuration to the OEMs fleet by fleet. So they tell them what engine and what clutch, etc they will prefer and we have tied up with a very prominent Tier-I player in the North American business, so we are very confident of driving on their network there. So the penetration strategies vary, but technology is surely not a barrier.

Participant: Any significant competition from any foreign company as such?

Udit Seth: In India or overseas?

Participant: No, in overseas.

Udit Seth: Overseas, yes, what our position is standing in India similarly to Fichtel & SACHS in Europe, Eaton Corporation has that standing in North America, Valeo as a company has that standing in the automotive car sector and LUK has that standing in the farm equipment sector. So, it is a fairly geographically single brand dominated space. And we have our challenges cut out for us.

Participant: Sir, last question is, can you expect the foreign subsidiaries to breakeven, the UK subsidiary which is there?

Udit Seth: Yes, we expect by next year we shall see a breakeven.

Moderator: Thank you. Our next question is from the line of Paras Adenwala from Capital Portfolio Advisors. Please go ahead.

Paras Adenwala: Just a kind of question on lending to group companies, the Rs. 40 crores thing that you have lent. I just wanted to know, if Setco Auto has any stakes in those companies?

Vinay Shahane: We have very minor stake, single-digit percentage stake in this company.

Paras Adenwala: And are any activities of those promoter entities beneficial to the activities of Setco Auto?

Udit Seth: There is no correlation.

Vinay Shahane: It is a totally different business. So that is why we have specifically given it as a preference share so that the money comes back, and as I told you, it will start coming from this financial year.

Paras Adenwala: So, within what period of time do you expect this entire amount to come back?

Vinay Shahane: In next three years.

Paras Adenwala: So this is one-off or do you see the balance sheet of Setco being used for funding the promoter entities?

Vinay Shahane: No. It will be one of it, it will be on a case to case requirement basis, so when the need arose we had invested but when they are on their own they will be repaying it in next three years as I told you. So, it just depends where the money can be better utilized.

Paras Adenwala: Because I am sure you will appreciate that from minority shareholder standpoint this can become a very sensitive issue.

Vinay Shahane: Right, we are aware of it.

Paras Adenwala: So, I would seriously suggest that

Vinay Shahane: Yes, we appreciate your view.

Paras Adenwala: And secondly on the export strategy, I am just trying to understand the export strategy, because at times when a large part of the globe is reeling under slowdown and that slowdown promises to hold on for some more time, why would you like to focus on exports where the gestation period has been elongated when the local economy is growing very rapidly. So, wouldn't it be appropriate to focus your energies and investments on your local market rather than focusing on exports?

Udit Seth: Actually, your point is well taken. Fortunately for us in the sector that we are focusing on we are garnering good position and acceptance in the local market. Hence as a bandwidth we are, there is a team which is specially dedicated to that, we have separate organization bandwidth which is dedicated to the growth and the servicing of the local market. So as such, human resources capital is allocated differently, capital expenditures only done when the volume justifies. So we do not see lack of focus in the local business at all, in fact, we are penetrating that a lot more and we are hoping that in the second half of this year one more OE is complete program, also they have nominated us as a full assembly manufacturer and we will see sales coming into the second half for that also. So, full focus is there on India.

Paras Adenwala: If I may ask about the total investment in setting up your export vertical, how much would it be so far?

Udit Seth: It would be close to about Rs. 70 crores - Rs. 75 crores.

Paras Adenwala: That you have already invested?

Udit Seth: Yes.

Paras Adenwala: And when do you see that coming back?

Udit Seth: Part of it was to acquire the brand in which we have been selling our products and to also acquire the technology which was with our erstwhile technical collaborator, it was not more to look at augmenting capacities or taking on manufacturing. And we do expect that in the next two to three years we should have more than recovered that investment.

Moderator: Thank you. Our next question is from the line of Mahantesh Sabarad SBI Cap Securities. Please go ahead.

Participant: I have two questions. Question number one, the Rs. 1,000 crores guideline that you have given, can you help us understand what could be the rough split in terms of the various business segments? And number two, I was looking at more from the casting business, what is the kind of external business that you are hoping to get? I assume this will be the non-clutch kind of business that you are hoping to get.

Vinay Shahane: Yes, taking your first question first. As explained earlier in the concall, we see a very positive and healthy outlook for OEM segment in next three to four years due to variety of reasons including the emissions norms, opening of mining sector. Plus, we are also diversifying into tractor and light commercial vehicle. So we expect the OE segment growth of the Company to register a growth of, I would say, average around 30% year-on-year. The Rs. 1,000 crores is for 2018 - 2019 on a standalone basis.

Participant: Sir, how much of this will be OE in Rs. 1,000 crores? I assume that you have partly answered by saying 12% roughly would be exports, so I assume that Rs. 100 crores - Rs. 120 crores of Rs. 1,000 crores will be exports.

Vinay Shahane: 12% export, just to correct your impression was for FY18, perhaps in FY19 where I am looking at Rs. 1,000 crores it would have crossed 15%. So exports could be around Rs. 150 crores - Rs. 175 crores.

Participant: Tractors would be another similar number?

Vinay Shahane: Yes, tractor will be part of my normal OEM or aftermarket when I am talking about, but yes tractor together, but if we are looking at segment wise let us calculate the figures on segment wise basis whether it is MHCV or tractor or LCV. So, OEM when I say around 30% growth year-on-year is including the LCV and the tractor business.

Participant: Sir, without tractor it will grow much slower?

Vinay Shahane: It will be around 20%. Tractor, what will happen, in the initial period the jump will be substantial, because when I start from zero base or the minimal base the growth will be in percentage terms very high but the absolute amounts will not be very significant in relation to the total volumes.

Participant: How will the replacement be?

Vinay Shahane: Replacement market should be growing at around 15% to 17% year-on-year.

Participant: And which of the replacement markets will grow faster for you, independent or the OES?

Vinay Shahane: Initially we look at OES, the OE aftermarket to grow fast, as we have explained earlier in the concall also that we have witnessed a downturn in OES due to lower OEM volumes in FY13 and FY14 and from FY15 the OEM segment has picked up. So that replacement of those vehicles with normal replacement cycle of two and a half years which will start around this year and will grow up for next two to three years, it will be on an increasing path. And in aftermarket it will have its own challenges and competition, the geographical penetration will be always a priority but yes, some competition will be there. In OES I have 100% market share, so that will help me to grow faster.

Participant: So I am just trying to again visualize that out of Rs. 1,000 crores Rs. 150 crores would be exports, another Rs. 100 crores - Rs. 150 crores could be tractors and the balance Rs. 700 crores would be sort of evenly distributed, probably Rs. 350 crores will be with OEM and the balance Rs. 350 crores from the replacement, both OES as well as other is that the right way to look at it?

Vinay Shahane: Yes, you can look at it that way or the other way if I look at it, OE could be in the range of around Rs. 400 crores to Rs. 450 crores, tractors and LCV everything included exports could be around Rs. 150 crores - Rs. 175 crores as I mentioned to you and aftermarket would be around Rs. 450 crores to Rs. 500 crores.

Participant: And the second question, the Lava Cast external customers, what kind of castings are you looking for?

Udit Seth: Basically, we have a certain box size available with us, so we are focusing on things like brake discs, rotors, fly wheels, forks, covers and pressure plates of course, the items which generally our current box accommodates as well as our collaborator has some technical expertise as well.

Participant: And these will come at better margins relative to the current set of casting products that are consumed internally or will it come near same or lower margins?

Vinay Shahane: The international business will be definitely at much better margins.

Participant: So you will have an international portion also, that means the exports out of those castings as well?

Vinay Shahane: Yes, right.

Participant: Will be therefore raw casting or will be machined casting?

Vinay Shahane: Will be fully machined castings only.

Participant: So, what is the machining facility that you currently have and what is the CAPEX that you will require to be able to, sort of, execute this strategy of machining fully the components?

Vinay Shahane: See, today for the foundry capacity of around 30,000 tons we have the machining capacity as per the requirement currently and maybe we will have to ramp up the capacity depending on the components required for the development under specific product requirements, maybe around nominal investment additional CAPEX of around Rs. 5 crores to Rs. 10 crores.

Participant: But the machining operations will be different from that cover housings?

Vinay Shahane: Yes, that is what I said. Depending on the component to be machined I will have to invest additionally in machining shop.

Participant: I will require different machining capability than…

Vinay Shahane: There could be some machining capacity, it will be basically auto components only, but yes each component will have its different characteristics and requirements. But really today when nothing is on the table, really it will be little too premature to judge what additional CAPEX would be.

Participant: And Setco Engineering, the related company where you have made an investment of preference shares, will it have a role in this portion of the business with its non clutch casting business to be supplied overseas?

Vinay Shahane: What kind of role you are referring to?

Participant: I am asking a question, is there any role that Setco Engineering will be playing in this part of the business.

Vinay Shahane: It will have no role in that business.

Participant: So what is Setco Engineering into, sir if I may ask?

Vinay Shahane: Typically, group investment company, the holding company of Setco Automotive. So basically they are investment company.

Moderator: Thank you. Our next question is from the line of Sushil Bhojwani from Elara Capital. Please go ahead.

Sushil Bhojwani: Just wanted to understand, I mean, given the cash flows and majorly the growth coming in from FY18 and FY19, how do we place ourselves with regards to the debt we have on the books? Do we have any plans to reduce it drastically in the next two years?

Vinay Shahane: The operations, the growth what we are looking at will ensure that debt definitely doesn't grow up on a standalone basis or on a consol basis, either way you look at it. And depending on fresh CAPEX or expansion plans, naturally the debts will be reduced.

Sushil Bhojwani: So, are we looking at any number?

Vinay Shahane: Not really, I mean, with the continuing debt plan what I have, my debt equity should improve standalone from around 1.1 to around 0.75 to 0.8.

Sushil Bhojwani: And just one more thing, we just had a question on the breakup for Rs. 1,000 crores, are we taking in any revenues from casting in this?

Vinay Shahane: No, it is standalone in FY18 - FY19. So casting revenue is standalone India operations, Lava Cast revenues will not be there nor of the foreign subsidiaries. **Sushil Bhojwani:** It will be add on.

Vinay Shahane: The consol will be add on.

Moderator: Thank you. Our next question is from the line of Himanshu Shah from Unlimited Potentialities. Please go ahead.

Himanshu Shah: Sir, I would like to know what if we put together the consolidated part of the business, what kind of revenues and margins we could look forward to in the next two, three years?

Vinay Shahane: The Rs. 1,000 crores mark will be achieved one year in advance, in FY18 we should reach the Rs. 1,000 crores on consol basis.

Himanshu Shah: And what kind of margins can we have on the consol business?

Vinay Shahane: Margins would not be drastically different than what we are having today, the foundry also will be working at optimal operational efficiency. So not any substantial variation in margins.

Himanshu Shah: The foundry will help us improve the margins in our own business?

Vinay Shahane: Foundry, yes because there will be some cost saving which will accrue because of my in-house better manufacturing facilities at foundry. So, some cost saving will be accruing to Lava Cast and Setco also.

Himanshu Shah: And one more question, this is about how will the automation of vehicles, automatic suspension impact the clutch business overall?

Udit Seth: Automatic suspension has nothing to do with the transmission, having said that, in the space of tractors and MHCVs we do not expect the automatic transmissions to come in. There are some very small vehicles which have something called the automated manual transmission, but that uses the clutch as well. So, I do not see it as a shift which will threaten the business for the next 20 - 25 years easily.

Himanshu Shah: But do these automatic transmission vehicles have clutch built into them or no clutch is there?

Udit Seth: Automatic transmission vehicles do not exist except for maybe a few low floor buses which you see at the airports. There is a automated manual transmission which exists but that uses a clutch.

Moderator: Thank you. Our next question is from the line of Pankaj Bobde from Axis Securities. Please go ahead.

Pankaj Bobde: Sir, I missed upon the names of the foreign competitors you mentioned,

Udit Seth: Eaton, Valeo, LUK and SACHS and there is Daikin EXEDY.

Pankaj Bobde: Sir, I have two questions. What is that edge we have over our global competitors which makes our product competitive enough in global market? Because as you said, technology would be universal, so what is that edge we have? And second question is, what is the connection between emission norms and the size of clutch you mentioned due to change in emissions norms we will require or larger clutch?

Udit Seth: I will answer your first question. I think it is just the cost effectiveness of being in India, plus we are a vertically integrated clutch manufacturer, we have almost everything that we use is made in-house. So we control our costs quite well. I think other than that there is no real advantage one would have in this space but with the foundry coming in we can supply additional parts like the clutch housing and fly wheels which allow us to further increase our stronghold in the power train. Coming to your second question which is related to emission standards, what tends to happen is that as the engines become larger, you need better clutches to transfer that power into the wheels. While doing that, one will have to reduce vehicle judder because judder is related to fuel efficiency as well as noise and also the vibration causes many other parts to fail and therefore the overall noise vibrations, harmonics is best tuned through a better dampening system that the clutch provides. So with the change in emission standards the clutch has to be able to deliver the performance that is required as per those emission standards. I don't know if I have been able to explain that.

Pankaj Bobde: Well, you partly explained but since emission is connected with engine and the effluents which are coming out of that, like we have to understand what would be the connection of clutch with that?

Udit Seth: So, when an engine is revved the power without any drag normally if you see, let's take an example, if you see a truck going up the ghats from Bombay to Pune, you will see the vehicle going at a very sluggish space. That sluggishness is not there because of any other reason but a badly designed power to weight ratio which spoils your petrol consumption, which increases your transportation time from point A to point B and could cause premature clutch failure which again breaks the vehicle down. Emission is not purely related to the smoke that comes out of the vehicle but also related to the noise and the fuel efficiency. So, as the engines and the power changes the clutch dies and the dampening effect that it provides in the power train changes.

Pankaj Bobde: So is there any scale wherein these things can be calibrated and where do we stand on that scale, if there is any?

Udit Seth: There are NVH measuring equipments which allow you to take measurements in various clutches and trucks in various different operating conditions in India and outside and we do that as a company and that is the best way to understand how to recommend a better clutch. India uses a Euro-IV standard while Europe is in Euro-VI. So we are two generations behind as far as emission standards are concerned but we are going to skip Euro-V and jump straight to Euro-VI. So as a company we are now trying to understand requirement not for Euro-VI but for Euro-VII for our engineering standards.

Pankaj Bobde: So as compared to the competition, I mean, the global competition, where do we stand compared to them on these standards?

Udit Seth: See, we provide standards basis these markets that we enter into. So, we cannot penetrate in American market or a European market with an Indian product, we have to engineer the product basis the factor of safety and the ratios and the operating conditions are in those markets and that is how we do it. So, product to product the engineering will vary.

Pankaj Bobde: But, I mean to say, where do we stand as compared to the competitors?

Udit Seth: We have the technology and we stand equal or better as far as they are there and we do have R&D capabilities in India and UK, so we are constantly in very close touch with the requirements that European leaders kind of expect from clutch manufacturers.

Pankaj Bobde: So, can I conclude that we are at par as far as technology is concerned compared to our global competition and we have that competitive advantage and the price benefit as compared to our global competition?

Udit Seth: Yes, that is right.

Moderator: Thank you. Our next question is from the line of Prashant Biyani from JHP Securities. Please go ahead.

Prashant Biyani: Do driverless vehicles require automatic transmission or manual transmission?

Udit Seth: Automatic transmissions are in driver less vehicles, but that is limited to cars.

Prashant Biyani: And sir, like you said that we are fully technology capable when the export markets are concerned, so where are things stuck for our export market picking up?

Udit Seth: Our products are ready for delivery and we have already completed our field testing in North America, we do expect the supplies to start in the fourth quarter for that market. As far as Europe is concerned, we already do a small amount of business in mainland Europe but we do not see those volumes picking up unless and until we get OEM or OES nominations in those markets.

Prashant Biyani: Sir, for this nomination thing why are we not being nominated by the OEMs if we have the technology?

Udit Seth: It is a simple thing, in India for example, it took my father almost 14 years to be nominated as a clutch supplier with one of the OEMs which is a leader. Similarly, these OEMs have cultivated relationships with their existing partners over a period of time and just because somebody comes in cheaper they will not immediately discuss, they will try it out. So they have nominated us in their subsidiaries in India, so whether it is MAN, Volvo-Eicher or Bharat Benz, we are a single source supplier to them in India. And they have not brought their German product into India to supply into the market. Once they try us for a few years, they are comfortable with us, they understand how our management works, then they will hopefully take us the next step which is OES and then maybe OEM.

Prashant Biyani: Sir, do we supply to the Chinese market?

Udit Seth: No.

Prashant Biyani: Why would be that, sir?

Udit Seth: China has close to 90 clutch manufacturers and they operate on Chinese price points, which unless you are a local player you cannot compete with because a lot of those Chinese companies also have state given support and for us to understand that market would be a big dilution of our bandwidth, we do not see any price advantage of going into China, except to be able to cater to the Chinese market. And then there is a concern on the IP side of things as well. So, right now our ambition is international business which is non-Chinese in nature.

Prashant Biyani: But quality wise their clutch is also same?

Udit Seth: It depends from clutch manufacturer to clutch manufacturer, and important thing to note is that unlike many other products clutches require service and therefore it is not just about manufacturing the product but also servicing the product and being able to address the market requirements in those markets locally with people over there, so you need to be able to address the language barriers and the service barriers that are there. And so from our experience, we have seen the Chinese product come in at a much cheaper cost but without any kind of service or any kind of recourse in case there is a problem. Which is the reason why when one of the Chinese OEMs decided to put up a plant in India they did not come with the Chinese clutch manufacturers, they nominated us as the clutch of their choice, it is a different story why that project got delayed, but clutch is not just manufacturing but also equally serviceability.

Prashant Biyani: And just to confirm, the electric vehicles would require clutch, it is not that the clutches are not there in electric vehicles?

Udit Seth: Electric vehicles do not have clutches.

Moderator: Thank you. We have the next question from the line of Deep Shah from SBI Cap Securities. Please go ahead.

Deep Shah: A few questions. First to start with, are we intend to or are we looking at any inorganic or any acquisition targets that you may have to achieve this Rs. 1,000 crores mark during this course of time i.e. in the next two to three years?

Udit Seth: No.

Deep Shah: So there are no particular targets basically, at this point of time?

Udit Seth: No.

Deep Shah: And secondly, I was looking at some of the BSE filings, you have floated UAE subsidiary, so can you just clarify what is the rational there?

Udit Seth: We see a requirement to be able to supply into the greater area of the Middle East quite quickly and some of the markets to go from India and supply material from is very difficult. Therefore, we said it is better, we had our distribution setup over there, we converted into wholly owned subsidiary so that our people on our payroll can go into the Iran and the other markets which are there, African markets which are much easily connected from Dubai. So for example, I want to go into Tanzania, Kenya, Nigeria or where ever, Dubai becomes a much faster service, sales and distribution point as opposed to India. Hence, we set the subsidiary up.

Deep Shah: And last question would be, if I understand correctly, we are the leaders in the M&HCV segment and as a part of our target of achieving Rs. 1,000 crores top-line we are not focusing on other segment that is farm equipment and LCVs and stuff like that, that means you are anticipating a grab in market share from other players. So what are the things that you will be looking at, is this pricing penetration strategy or how it is going to pan out?

Udit Seth: We are not going into the other segments because we expect a risk in the current segment, we are just growth oriented as a Company and we see an opportunity in yet another segment which has got a different cycle from the M&HCV sector, so it will allow us to tide over the cyclical nature of being in one segment. The technology is not a rocket science or deeply different and like the M&HCV sector the farm equipment sector also has a strong replacement market. So philosophically, both the markets have different cycles but provide similar opportunities, hence it is only natural progression to want to stabilize and consolidate one market and then try and penetrate the other.

Deep Shah: So sir, basically the farm equipment products and LCV products, is this the first time we are going to supply or we…

Udit Seth: Traditionally when Setco formed as Gujarat Setco Clutch Limited, it was a multi-segment, multi-product company, we had products which were non-OEMs but across tractor, cars, LCVs, MHCVs we took a structured decision in 1999 - 2000 to focus on the MHCV segment because that is where the emission standard and therefore the clutch changed. And that focus has strategically paid off really well for us. Now that we have established ourselves in that sector, we can go back but the clutch which we made traditionally in 1984 for the farm tractor and the clutch today, it is extremely different, it is miles apart, the dampening systems are different, the friction material has changed, the springs are far superior and the technology to engineer coefficient of friction are very different now. So, though we are reentering the market, it is complete reengineering.

Deep Shah: So sir, pricing of these products would be at par with the competition or it would be…

Udit Seth: You have to be at par with competition otherwise there is absolutely no opportunity to penetrate.

Deep Shah: So basically, it is not under cutting of the price or something?

Udit Seth: No, no. Margins are thin, it is also commoditized, so one should be very careful playing that game.

Moderator: Thank you. Ladies and Gentlemen, that was the last question for today. I would now like to hand over the floor to Mr. Vinay Shahane for his closing comments. Over to you, sir.

Vinay Shahane: Thank you, Ladies and Gentlemen, for participating in this conference call. We hope we have been able to address all the questions or the queries with each participant. And as a corporate, as we continue our journey on the stability and growth in top-line as well as the profitability and other operating efficiencies, we will be in touch with you on a regular basis. And if you have still any questions you are free to connect with us on the coordinates given on our corporate presentation.

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