June 10, 2019

# Dixon Technologies (India) Limited (erstwhile Dixon Technologies (India) Private Limited): Rating assigned to enhanced bank limits

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund-based -Term Loan | 7.50 | 5.50 | [ICRA]A+ (Stable); Outstanding |
| Fund-based - Working Capital Facilities | 50.00 | 95.00 | [ICRA]A1+; Assigned/Outstanding |
| Non-fund Based - Working Capital Facilities (Short term scale) | 235.00 | 390.00 | [ICRA]A1+; Assigned/Outstanding |
| Interchangeable^ Working Capital Facilities (Short term scale) | 150.00 | 250.00 | [ICRA]A1+; Assigned/Outstanding |
| Unallocated Bank facilities | 2.00 | 0.00 | - |
| Commercial Paper | 25.0 | 25.0 | [ICRA]A1+; Outstanding |
| **Total** | **469.50** | **765.50** | |

**Instrument details are provided in Annexure-1;*

*^ these limits are interchangeable between non-fund based and fund based*

## Rationale

The ratings take into account the healthy operating profile of Dixon Technologies (India) Limited (DTIL) characterised by its healthy scale of operations, which is expected to increase further in the current financial year on account of the recent consolidation in shareholding in one of the subsidiaries, and its track record of repeat business from the existing clients as well as addition of new clients. Further, the ratings positively take into account the diversification of revenue stream and the backward-integration measures in the key business segments, which have supported profitability improvements. The ratings also consider DTIL's comfortable financial profile characterised by low gearing, healthy debt coverage and adequate cushion in working capital facilities post the increase in limits. Further, the ratings draw comfort from the extensive experience of DTIL's promoters and its established clientele in the key business segments.

The long-term rating, however, is constrained by DTIL's dependence on its key clients, which renders its revenues susceptible to business plans and performance of clients. The revenue concentration, though less than the past, continues to be sizable. However, the strong profile of these two principals abates the risks associated with concentration to some extent. Further, the risk is mitigated by the strong position of DTIL as one of the largest and cost-efficient electronic manufacturing services (EMS) players. This also provides opportunities for adding new principals. The rating also factors in the dynamic nature of the electronics manufacturing industry, which exposes the players to risk of technological obsolescence. This in turn necessitates continuous upgrade of processes and products to sustain competitive advantage. ICRA has taken note of DTIL's increased working capital requirement, primarily due to higher receivable and inventory in FY2019, which is a credit concern. DTIL's subsidiary (Padget Electronics) has sizeable stuck receivables from a client in the mobiles segment, though the same is backed by a similar quantum of outstanding payables to the suppliers. DTIL has entered into an agreement with the client and supplier parties for the write-off of both receivable and creditor amounts. However, the same is subject to approval of the applicable authority. Given the sizable amount in context, the resolution of this issue will remain crucial and a key monitorable. Further, the working capital requirements and the utilisation of the borrowing limits will remain a key monitorable.

## Outlook: Stable

ICRA believes that DTIL will continue to benefit from the extensive experience of its promoters in the EMS business, its strong clientele and its position as a cost-efficient EMS player. The outlook may be revised to Positive if the company maintains its pace of revenue growth while achieving sustainable improvement in profitability and greater customer diversification. The outlook may be revised to Negative if it undertakes any major debt-funded capital expenditure or if a stretch in the working capital cycle weakens its liquidity.

## Key rating drivers

## Credit strengths

**Extensive experience of promoters in EMS business and established clientele:** The promoters of DTIL have more than two decades of experience in the EMS business. The company has developed an established clientele, which provides it with repeat business.

**DTIL's reputation as one of the largest and cost-efficient EMS players helps in securing stable business:** Over the years, DTIL has augmented its manufacturing capacities alongside acquiring cost competency to become one of the largest and cost-efficient EMS players in the country. These strengths provide DTIL opportunities to add new principals. This also helped the company to withstand the loss of a large client in the past.

**Diversified revenue streams among consumer electronics, lighting and mobiles segments:** DTIL's revenues are diversified into consumer electronics (CE), lighting, home appliances and mobiles segments. The company started manufacturing mobile phones under its subsidiary Padget Electronics Private Limited (erstwhile JV) in FY2016. The segment contributed to ~12% of revenues of DTIL in FY2019. In April 2019, the company consolidated its shareholding in PEPL to 100%. In FY2018, DTIL and Aditya Infotech Ltd. formed a joint venture (JV) to set up facilities for manufacturing security devices like surveillance camera, etc. These factors have also resulted in a diversified revenue stream for DTIL. This in turn is expected to result in an increase in the revenue scale in FY2020 onwards with higher product diversification.

**Comfortable financial profile with strong debt coverage, low gearing and sufficient liquidity:** The coverage indicators of the company moderated in FY2019, due to higher working capital requirement (both fund-based and non-fund based working capital). However, the overall credit profile remains comfortable as reflected in low gearing ratio of 0.4 times at end of March 2019, comfortable debt coverage profile indicated by interest coverage ratio of 5.6 times and debt service coverage ratio of 4.0 times. The availability of adequate working capital facilities also support its liquidity position.

## Credit challenges

**Dependence on customers' business plans and performance; however, strong patronage of its key principals abates the associated risks to some extent -** As is prevalent in the industry, the company's revenues are closely linked to the business plan and performance of its principals. A major part of DTIL's revenues and operating profitability is derived from its top two customers – Philips and Panasonic. However, ICRA derives comfort from the company's long relationship with the clients (Phillips – over nine years; Panasonic – over five years) and their strong patronage. While the risks of customer loss and product obsolescence remain, the company has a demonstrated track record of withstanding such losses in the past. Nevertheless, it needs to make continuous efforts to maintain its cost competitiveness and upgrade to new products, given the dynamic nature of the product segment. Despite the long-standing relationships, the company's ability to get repeat business is linked to the performance and plan of the clients and the technology involved.

**Stiff competition from other contract manufacturers and in-house manufacturing capacities of OEMs:** The company faces competition from other EMS players besides exposure to in-house capacities of brands, which limits its pricing flexibility and bargaining power with customers, thereby putting pressure on margins in segments like CE and mobiles. The competition has increased following the entry of globally competitive contract manufacturing players in the domestic market in the recent years.

**Increase in its working capital requirements:** DTIL's working capital requirement increased over the years on account of its growing scale of operations and higher receivable cycle. While it was able to manage these partly by higher credit period from its suppliers, the overall working capital requirement increased. Further, ICRA notes that the financial profile of one of the clients in the mobiles segment deteriorated significantly, leading to long pending receivables. Nonetheless, the company had corresponding payables from its suppliers and an agreement with both clients and suppliers for back-to-back arrangement. Recently, DTIL entered into an agreement with the client and supplier parties for the write-off of both receivable and creditor amounts. However, the same is subject to approval of the applicable authority. Given the sizeable amount in context, the resolution of the issue will remain crucial and a key monitorable. Also, the overall working capital profile will be a key rating sensitivity.

**Risk of technological obsolescence necessitates continuous upgrade of processes and products to sustain competitive advantage**: The electronic products industry is characterised by continues product and process innovation and rapid adoption of new technology. Given the risk of technological obsolescence, the industry players are required to undertake continuous upgrades to sustain competitive advantage.

## Liquidity position

The working capital requirements of DTIL have increased in H2 FY2019, resulting in an increase in the usage of fund-based and non fund-based borrowing. Therefore, the liquidity profile of the company has moderated. However, the same is adequate post the enhancement in borrowing limits. The company had an unencumbered cash balance of Rs. 37.4 crore at the end of April 30, 2019 and cushion in utilisation of fund-based working capital limits of ~Rs. 69.0 crore from drawing power at the end of April 30, 2019, as per the data shared by the company.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology |
| Parent/Group Support | Not applicable |
| Consolidation / Standalone | The rating is based on consolidated financial statements of the issuer, which includes its subsidiaries and JVs |

## About the company

Dixon Technologies (India) Limited (DTIL), incorporated in 1993 by Mr. Sunil Vachani, is a diversified EMS player with operations in various subsegments of the electronics vertical. DTIL has operations in the CE, lighting, home appliance segments and also undertakes reverse logistics operations. Besides, the company undertakes manufacturing of mobiles and security surveillance equipment (CCTV camera and DVR) through its two JV companies, Padget Electronics Private Limited (a 50% JV with the Jaina Group) and AIL Dixon Technologies Private Limited (a 50% JV with Aditya Infotech Ltd).

TV manufacturing, part of the CE vertical, is the largest segment for DTIL. This segment has significantly supported the revenue growth in the recent years. In the home appliances segment, the company has range of 100% original design manufacturing (ODM) products. This segment and backward integration in the lighting segment has supported profitability improvements in the recent years. DTIL has manufacturing facilities in Noida (Uttar Pradesh), Dehradun (Uttarakhand), and Tirupathi (Andhra Pradesh). In April 2019, DTIL consolidated its shareholding in one of the subsidiaries to 100%, buying the stake of other shareholders in an all-cash deal.

In September 2017, the company came out with an IPO worth ~Rs. 600 crore, which involved ~Rs. 60 crore of fresh equity issuance and the remaining as offer for sale from promoter/investors. In FY2018, the company reported a net profit of Rs. 60.9 crore on an operating income (OI) of Rs. 2,841.6 crore compared with a net profit of Rs. 47.6 crore on an OI of Rs. 2,457.0 crore in the previous year.

## Key financial indicators

| | FY2017 (Audited) | FY2018 (Audited) | FY2019 (Abridged) |
|---|---|---|---|
| Operating Income (Rs. crore) | 2,457.0 | 2,841.6 | 2990.1 |
| PAT (Rs. crore) | 47.6 | 60.9 | 63.3 |
| OPBDIT/OI (%) | 3.7% | 4.0% | 4.7% |
| RoCE (%) | 32.5% | 30.2% | 25.4% |
| | | | |
| Total Debt/TNW (times) | 0.3 | 0.4 | 0.4 |
| Total Debt/OPBDIT (times) | 0.6 | 1.2 | 1.0 |
| Interest Coverage (times) | 5.9 | 8.4 | 5.6 |

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years

| | | Current Rating (FY2020) | | | | Chronology of Rating History for the Past 3 Years | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Date & Rating | Date & Rating in FY2019 | | Date & Rating in FY2018 | Date & Rating in FY2017 | |
| | Instrument | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | June 2019 | March 2019 | September 2018 | October 2017 | February 2017 | September 2016 |
| 1 | Fund-based - Term Loan | Long Term | 5.50 | 5.5 | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | [ICRA]A+ (Stable) | [ICRA]A (Stable) | [ICRA]A (Stable) |
| 2 | Fund-based - Working Capital Facilities | Short Term | 95.00 | - | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1 | [ICRA]A1 |
| 3 | Non-fund Based-Working Capital Facilities | Short Term | 390.00 | - | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1 | [ICRA]A1 |
| 4 | Interchangeable -Working Capital Facilities | Short Term | 250.00 | - | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | - | - | - |
| 5 | Commercial Paper | Short Term | 25.0 | - | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1 | - |

## Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

## Annexure-1: Instrument details

| ISIN No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Fund-based - Term Loan | 18-Nov-2015 | NA | 30-Sep-2020 | 5.50 | [ICRA]A+ (Stable) |
| NA | Fund-based - Working Capital Facilities | NA | NA | NA | 95.00 | [ICRA]A1+ |
| NA | Non-fund Based-Working Capital Facilities | NA | NA | NA | 390.00 | [ICRA]A1+ |
| NA | Interchangeable Working Capital Facilities^ | NA | NA | NA | 250.00 | [ICRA]A1+ |
| NA | Commercial Paper | * | * | * | 25.0 | [ICRA]A1+ |

** Commercial paper not placed as of May 31, 2019; ^ between non-fund based and fund based*

*Source: DTIL*

## Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| Dixon Global Private Limited | 100.00% | Full Consolidation |
| Padget Electronics Private Limited | 50.00%* | Equity Method^ |
| AIL Dixon Technologies Private Limited | 50.00% | Equity Method |

** The ownership has increased from 50% to 100% in Q1-FY2020*

*^Equity method of consolidation has been used till FY2019 as the entity was 50% owned by DTIL till FY2019.*

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## About ICRA Limited:

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

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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