October 03, 2019

# Dixon Technologies (India) Limited (erstwhile Dixon Technologies (India) Private Limited): Ratings reaffirmed; rated amount enhanced

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund-based -Term Loan | 5.50 | 4.70 | [ICRA]A+ (Stable); Reaffirmed |
| Fund-based - Working Capital Facilities | 95.00 | 95.00 | [ICRA]A1+; Reaffirmed |
| Non-fund Based - Working Capital Facilities (Short term scale) | 390.00 | 635.00 | [ICRA]A1+; Reaffirmed |
| Interchangeable^ Working Capital Facilities (Short term scale) | 250.00 | 250.00 | [ICRA]A1+; Reaffirmed |
| Unallocated Bank facilities (Short term scale) | 0.00 | 45.30 | [ICRA]A1+; Reaffirmed |
| Commercial Paper | 25.00 | 25.00 | [ICRA]A1+; Reaffirmed |
| **Total** | **765.50** | **1055.00** | |

*^ between non-fund based and fund based, *Instrument details are provided in Annexure-1*

## Rationale

The ratings take into account the healthy operating profile of Dixon Technologies (India) Limited (DTIL) characterised by its established track record as an electronic manufacturing services (EMS) player with presence in diversified product segments, leading position in its key product segments (like LED television, lighting, and washing machines) and its reputed clientele with repeat business and long relationship. The ratings also consider DTIL's healthy financial profile characterised by moderate leverage, strong return on capital employed, and healthy debt coverage. Further, the ratings positively take into account the backward-integration measures in its key business segments, which have supported its growth and improvement in profitability over the years.

The long-term rating, however, is constrained by DTIL's dependence on a few large clients, which renders its revenues susceptible to their business plans and performance. The revenue concentration, though improved over the years, remains due to the high dependence on the top three clients. However, the strong profile of the large principals, and DTIL's position as one of the largest and cost-efficient EMS players in India, abates to an extent the risk of business loss from a large client. The rating also factors in the competitive and dynamic nature of the electronics manufacturing industry, which exposes the players to risk of technological obsolescence, foreign exchange fluctuation and regulatory changes. This in turn necessitates continuous upgrade of processes and products to sustain competitive advantage, requiring regular capital expenditure. ICRA takes note of DTIL's increased working capital requirement with the addition of a large client in Q4 FY2019. The working capital intensity (Net Working Capital Requirement/Operating Income) increased to 11.5% in FY2019 from 6.9% in FY2018. The same also led to an increase in debt to Rs. 240.4 crore as on March 31, 2019 from Rs. 130.9 crore as on March 31, 2018 (both inclusive of bill discounting facilities). The total outside liabilities (TOL) at the consolidated level also remained elevated as one of DTIL's subsidiaries (Padget Electronics Private Limited, which was earlier a joint venture/JV) has sizeable payables to suppliers in the mobiles segment, though the same is backed by a similar quantum of outstanding receivables from a client. DTIL has entered into an agreement with the client and supplier parties for waiver of both receivable and payable amounts. However, it is awaiting certain approvals before writing it off from its balance sheet.

## Key rating drivers and their description

## Credit strengths

**Established track record and market position in EMS business; established clientele:** DTIL has more than two decades of experience in the EMS business and has established a track record and a leadership position in the key segments in which it operates, i.e. LED television, lighting, and washing machine. 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 have helped DTIL in adding new principals as well as maintaining healthy relationship with its clients, resulting in repeat business.

**Reputed clientele and diversified revenue streams across product segments:** DTIL's clientele comprises some strong and reputed global brands like Phillips, Panasonic, Xiaomi, etc. The company's revenues are also diversified across product segments like consumer electronics (CE, mainly LED television), lighting, home appliances (mainly washing machines), mobiles, and security devices. While the CE, lighting, and home appliances segments are catered to by DTIL, the mobile phones and security devices manufacturing come under its subsidiary Padget Electronics Private Limited (erstwhile JV) and AIL Dixon Technologies Private Limited (JV with Aditya Infotech Limited), respectively. The presence across multiple product segments provides DTIL a diversified revenue stream and growth opportunities across segments.

**Healthy financial profile with moderate leverage and healthy debt coverage metrics:** DTIL's financial profile remains healthy, though there has been some moderation in FY2019 with the increase in working capital requirement. Alongside the improvement in the company's operating profitability in FY2019 supported by backward integration, its working capital requirement increased. This resulted in moderation of its return on capital employed (RoCE) and leverage ratio. Consequently, the debt coverage indicators of the company moderated in FY2019. However, the credit profile remained healthy as reflected in interest coverage ratio of 5.6 times and debt service coverage ratio of 4.0 times in FY2019. The availability of adequate sanctioned working capital facilities also provides cushion in its liquidity position to withstand working capital requirement. With the expected increase in its scale of operations, and steps towards reducing working capital intensity, the DTIL's credit metrics are expected to improve in FY2020.

## Credit challenges

**Dependence on customers' business plans and performance; however, strong patronage of its key principals abates associated risks to an 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 three customers – Philips, Panasonic, and Xiaomi. However, ICRA derives comfort from the company's long relationship with two of the top three clients (Phillips – over 13 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.

**Competition and risk of technological obsolescence necessitates continuous upgrade of processes and products:** The electronic products industry is characterised by continuous 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. 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, which face relatively more competition. The competition has increased following the entry of globally competitive contract manufacturing players in the domestic market in the recent years. Further, the company is exposed to risks pertaining to regulatory changes (like custom duty, taxation, etc.) and foreign exchange exposure, given its sizeable imports. However, the forex risk is abated to an extent with the company's ability to partly pass-on the variation.

**Increased 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. DTIL's TOL/TNW ratio was high at 3.2 times as of March 31, 2019 due to high creditors and working capital borrowings. However, ICRA notes that in the past, the financial profile of one of its clients in the mobiles segment (in subsidiary) deteriorated significantly, leading to long pending receivables, while the subsidiary had corresponding payables from suppliers and an agreement with both clients and suppliers for back-to-back arrangement. Subsequently, DTIL's subsidiary entered into an agreement with this client and the corresponding suppliers for the waive-off of both receivable and creditor amounts. However, DTIL is yet to write-off the same, pending approval from a regulatory authority. Hence, the creditor and receivables appear higher to that extent. Adjusting for the same, the TOL/TNW stood at 2.65 times as of March 31, 2019. Nevertheless, given the sizeable amount in context, the resolution of this issue will remain crucial and a key monitorable, besides the overall working capital intensity of the company.

## Liquidity position: Adequate

The company had an unencumbered cash balance of Rs. 37.4 crore at the end of April 30, 2019 and cushion in working capital limits (fund-based limit utilisation averaged at ~40% of the sanctioned limit, and ~63% of the available drawing power in the six-month period between February 2019 to August 2019). This apart, the cash accruals for FY2020 are expected to be adequate to meet the planned capex and debt servicing obligations.

## Rating sensitivities

**Positive triggers** – ICRA could upgrade DTIL's rating if the company maintains its pace of revenue growth while achieving sustainable improvement in profitability and greater customer diversification and improvement in financial profile. Specific credit metrics that could lead to an upgrade of DTIL's rating include improvement in adjusted[1] TOL/TNW to below 2.4 times.

**Negative triggers** – Negative pressure on DTIL's rating could arise if the loss of any large client or slowdown in its key product segments materially affects its financial performance. The ratings could be downgraded if any increase in working capital intensity results in weakening of its liquidity position or stretching payables results in an increase in leverage with adjusted TOL/TNW of over 3.25 times on a sustained basis.

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[1] *Adjusted TOL: The TOL has been adjusted for payables to suppliers of a principal in the mobiles segment, given the back to back arrangement on receivables for the same and an agreement with the client and supplier parties for the waiving-off of both receivable and payable amounts. Thus, the amount of payables has been excluded from TOL for computation of the adjusted TOL.*

## 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 in subsidiary/ JV companies.

TV manufacturing, part of CE vertical, has been the largest segment for DTIL, over the years. The company has recently added Xiaomi as a customer for the segment. This in turn has supported growth in segmental volumes and revenues. 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 ventured into mobiles manufacturing in 2016 through it JV (50%) Padget Electronic Pvt. Ltd. with the Jaina Group. DTIL consolidated its shareholding in the company with the acquisition of the JV partner's share in April 2019. Thereafter, PEPL become a wholly owned subsidiary of DTIL. In January 2018, the company entered into manufacturing of surveillance and security equipment like closed circuit television cameras (CCTVs) and digital video recording (DVR) through AIL Dixon Technologies Private Limited, its 50% JV with Aditya Infotech Ltd. DTIL has manufacturing facilities in Noida (Uttar Pradesh), Dehradun (Uttarakhand), and Tirupathi (Andhra Pradesh). In September 2017, the company came out with an IPO worth ~Rs. 600 crore, which involved ~Rs. 60 crore of fresh equity issuance and remaining as offer for sale from promoter/investors.

In FY2019, the company reported a net profit of Rs. 63.4 crore on an operating income (OI) of Rs. 2,984.4 crore compared to a net profit of Rs. 60.9 crore on an OI of Rs. 2,841.6 crore in the previous year.

## Key financial indicators (audited)

| | FY2018 | FY2019 |
|---|---|---|
| Operating Income (Rs. crore) | 2,841.6 | 2,984.4 |
| PAT (Rs. crore) | 60.9 | 63.4 |
| OPBDIT/OI (%) | 4.0% | 4.6% |
| RoCE (%) | 30.4% | 23.2% |
| | | |
| Total Outside Liabilities/Tangible Net Worth (times) | 2.4 | 3.2 |
| Total Debt/OPBDIT (times) | 1.2 | 1.8 |
| Interest Coverage (times) | 8.0 | 5.2 |
| DSCR | 5.2 | 3.8 |

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

## Any other information: None

## Rating history for past three years

| | Instrument | Rating (FY2020) Type | Amount Rated | Amount Outstanding | Current Rating 3-Oct-2019 | Earlier Rating 10-Jun-2019 | Rating History for the Past 3 Years FY2019 1-Mar-2019 | FY2019 20-Sep-2018 | FY2018 6-Oct-2017 | FY2017 16-Feb-2017 | FY2017 19-Sep-16 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Fund-based - Term Loan | Long Term | 4.70 | 4.70 | [ICRA]A+ (Stable) | [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 | [ICRA]A1 |
| 3 | Non-fund Based - Working Capital Facilities | Short Term | 635.00 | - | [ICRA]A1+ | [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+ | [ICRA]A1+ | - | - | - |
| 5 | Unallocated Bank facilities | Short Term | 45.30 | - | [ICRA]A1+ | - | - | - | - | - | - |
| 6 | Commercial Paper | Short Term | 25.00 | - | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1 | - |

*Amount in Rs. Crore*

## 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 | 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 | 4.70 | [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 | 635.00 | [ICRA]A1+ |
| NA | Interchangeable^ Working Capital Facilities | NA | NA | NA | 250.00 | [ICRA]A1+ |
| NA | Unallocated Bank facilities | NA | NA | NA | 45.30 | [ICRA]A1+ |
| - | Commercial Paper | * | * | * | 25.00 | [ICRA]A1+ |

** Commercial paper not placed as of September 30, 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% | Proportionate Consolidation Method/ Equity Method^ |
| AIL Dixon Technologies Private Limited | 50.00% | Proportionate Consolidation Method/ 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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