July 26, 2024

Daikin Airconditioning India Private Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Unallocated	100.00	100.00	[ICRA]AAA (Stable); reaffirmed
Issuer Rating	-	-	[ICRA]AAA (Stable); reaffirmed
Total	**100.00**	**100.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation reflects ICRA's expectations that the credit profile of Daikin Airconditioning India Private Limited (DAIPL) will remain stable on the back of its strong business position in the domestic air conditioning industry, good brand recall particularly in the room air conditioning (RACs) and variable refrigerant volumes (VRV) segments. The rating continues to derive comfort from DAIPL's strong business linkages with its parent company, along with the demonstrated history of support in the form of equity infusions by Daikin Industries Limited (DIL; rated A2 with Stable outlook by Moody's), and expectations of continued support, going forward.

DAIPL has a strong market position in the Indian AC market, supported by a diversified product profile and a widespread distribution network. The company's operating income (OI) grew by ~43% and ~20% in FY2023 and FY2024, respectively led by strong demand in the domestic market. Moreover, DAIPL is expected to report a healthy revenue growth in FY2025, supported by strong sales volumes in Q1 FY2025 amid harsh summer and heat waves. The company's growth momentum is expected to continue in the medium term, given the favourable demand outlook for the air conditioning industry in India with growing number of ACs per household amid weather changes, rising urbanisation and increasing disposable income. India is one of the fastest growing markets among the economies where DIL operates, hence DAIPL remains a key strategic asset for DIL. In addition to growing Indian demand, DAIPL is expected to cater to various export markets where DIL operates, which augurs well for DAIPL's long-term growth prospects.

The rating strengths are partially offset by the vulnerability of the company's profitability to any adverse movement in input costs as the ability to pass on large price increases in a competitive market remains limited, which is reflected in a decline in the OPM in FY2022 and FY2023. Moreover, changes in regulations and energy efficiency standards can impact the company's cost structure as well. This apart, the company has a sizeable ongoing capex plan, at Sricity, Andra Pradesh, for adding capacity as well as achieving desired backward integration, given the company has notable import dependence for various components, which exposes it to forex rate fluctuations and supply-side shocks. DAIPL's ability to successfully ramp up production and achieve desired backward integration benefits remain crucial. While the capex is large compared to the current balance sheet size, internal cash generation from the business and equity infusion from the parent company are expected to be sufficient for the proposed capex.

The Stable outlook on the [ICRA]AAA rating reflects ICRA's expectations that DAIPL's credit profile will remain strong, supported by its market position in India, close integration with its parent and expectation that it will maintain a strong liquidity profile, coupled with limited borrowing levels.

Key rating drivers and their description

Credit strengths

Strong operational and financial linkages with parent, DIL – DAIPL enjoys a strong relationship with DIL in terms of transfer of technology, technical know-how, supply of key raw materials, etc. DAIPL also has a representation in DIL's board of directors. This apart, DAIPL is strategically important for DIL as it is a key supplier to other geographies and is expected to play a key role in DIL's R&D efforts. DIL is the global leader in the AC business with presence in more than 170 countries. DIL is expected to provide operational, technological and financial support to DAIPL. The Indian arm procures key components from DIL, which include compressors among others. This apart, DIL provides funding support in the form of equity infusion to DAIPL, as and when needed. DAIPL has received Rs. 600-crore equity infusion in June 2024 for its ongoing capex requirements.

Strong market presence with healthy market share in India's RAC and VRV segments – DAIPL has a sizeable market share in the Indian AC industry. The company's top-line growth remained robust in the past couple of years, except in FY2021 due to the pandemic. It remains the market leader in the VRV segment and maintains a healthy and increasing market share in inverter RACs. Technological support from its parent gives DAIPL an edge over its competitors in new technology innovation and product launches. DAIPL has a sales and distribution network comprising over 14,700 touch points. DAIPL derives maximum revenue from the dealers and distributors channel, followed by regional and national retail chains, Daikin Solutions Plazas, e-commerce platforms, and AC and consumer durable dealers. DAIPL's OI grew significantly in FY2023 and FY2024, led by strong demand in the domestic market.

Healthy financial profile, strong liquidity and efficient working capital management – DAIPL's financial profile remains strong with growing cash accruals on the back of healthy volumetric growth. The company continues to have an unleveraged capital structure (barring some working capital utilisation in FY2024) and solid coverage metrics. The liquidity position is strong due to healthy cash and cash equivalents, and substantial unutilised working capital limits. DAIPL's working capital management remains efficient with a modest level of working capital intensity, which is internally funded. The company has embarked on a large-sized capex plan of ~Rs. 1,400 crore, which will include capacity expansion and backward integration as well as an associated R&D centre for FY2025-FY2027. The same is expected to be funded through internal accruals and equity from its parent.

Favourable long-term outlook for India's AC industry, given low penetration levels – Increasing urbanisation and rising standard of living are fast making ACs a requirement across India, reflected in the growing number of RACs per household. However, the segment is still considered one of the least penetrated consumer durable segments, with less than 10% penetration of the total market size. Other factors supporting demand include weather changes and easy availability of consumer financing.

Credit challenges

Vulnerability of profitability to input cost fluctuations – DAIPL's profitability is prone to volatility in raw material prices, which is reflected in moderation in OPM in FY2022 and FY2023. However, the company has hiked prices across product categories over the last 2-3 years, which has mitigated the impact of the rise in input cost to an extent. This apart, the company has started manufacturing critical components inhouse, which is likely to ease some pressure on DAIPL's margin profile. Going forward, DAIPL's margins are expected to remain range bound.

Large capex undergoing, timely commencement of production crucial – DAIPL is undertaking a large capex of ~Rs. 1,400 crore, which would be completed by FY2027. The capex is related to doubling the existing installed capacity and setting up backward integration towards component manufacturing such as compressor, motor, heat exchanger, plastic moulding, etc. Hence, timely commencement of commercial production remains crucial for sustaining a healthy revenue growth. Moreover, achievement of backward integration benefits with reduction in import dependency on components leading to improvement in margins, remains key.

High import dependence with exposure to forex risks – DAIPL imports 35-40% of its raw material requirement, a major part of which is from the Group companies. This exposes it to forex movement risk, price volatility and supply-side shocks. However, the company hedges 90-95% of forex exposure. Moreover, the company plans to commence commercial production of additional AC components, which is expected to reduce import dependency gradually.

Liquidity position: Strong

DAIPL's liquidity position is **strong**, supported by strong operational cash flows, large unutilised working capital limits (~31% average utilisation against Rs. 1,550 crore of working capital demand loan/ cash credit in the last 15 months ending in June 2024 and healthy cash and cash equivalents of Rs. 1,472 crore as of June 2024. The company has planned capex of ~Rs. 1,400 crore for FY2025-FY2027, which is expected to be funded by internal accruals and equity from the parent. The company has already received Rs. 600-crore equity from DIL in June 2024.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Pressure on DAIPL's rating could arise if there is a sharp deterioration in the company's earnings, or if any major debt-funded capex weakens its credit metrics. The ratings could also be downgraded if there is a deterioration in the parent company's credit risk profile or weakening of DAIPL's linkages with its parent company.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	ICRA expects DAIPL's parent, DIL, to extend operational and financial support to DAIPL, should there be a need. DAIPL has strong business linkages with DIL and shares a common name with its parent company. Moreover, India is an important market for DIL and, hence, DAIPL is of high strategic importance to its parent.
Consolidation/Standalone	The ratings are based on the consolidated financials of DAIPL and its 100% subsidiary, Citizen Industries Private Limited (CIPL).

About the company

DAIPL, a wholly-owned subsidiary of DIL, manufactures and sells RAs, VRVs, Sky Air, packaged ACs (ducts) and chillers, among others, under the Daikin brand. Initially, DAIPL serviced the Indian market through imports from DIL's facilities in Japan, Thailand and Malaysia. In 2009, the company commenced production from its own manufacturing unit in India with the production of chillers. Later, it started manufacturing VRVs, HFC-32 refrigerant, high-wall split ACs, packaged ACs and Sky Air cassettes from its plant. The company has been undertaking a large capex to double its finished goods capacity, backward integrate into manufacturing AC components from Sri City, and develop an additional R&D centre at Neemrana. The investment in component manufacturing has been covered under the Government of India's production linked incentive (PLI) scheme of Rs. 538.7 crore, which will be an added fiscal benefit. The existing manufacturing unit and R&D centre is at Neemrana, with an installed manufacturing capacity of 1.5 million RACs and substantial capacity for other AC products. Once the manufacturing plant at Sri City becomes fully operational, DAIPL will have production capacity of 3.0 million RACs (as of now 2.0 million operational) and 2.8 million compressors. Besides, most other components such as heat exchanger, copper tubing, motor, cross flow fan, plastic molding, sheet metal components, printed circuit board, etc., will be available in house.

Key financial indicators (audited/Provisional)

DAIPL consolidated	FY2022	FY2023	FY2024*
Operating income	4,834.7	6,815.0	8,178.2
PAT	231.0	306.2	308.0
OPBDIT/OI	9.5%	8.1%	9.2%
PAT/OI	4.8%	4.5%	3.8%
Total outside liabilities/Tangible net worth (times)	0.9x	0.8x	0.9x
Total debt/OPBDIT (times)**	0.2x	0.1x	0.6x
Interest coverage (times)	15.4x	11.1x	7.7x

*Source: Company, *provisional financials submitted the company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. Crore*
Note: All financial ratios as per ICRA's calculation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current rating (FY2025)			Chronology of rating history for the past years		
	Type	Amount Rated (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & Rating in FY2022	Date & Rating in FY2021
			July 26, 2024	April 6, 2023	Jan 28, 2022	Nov 30, 2020
1 Unallocated	Long Term	100.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
2 Issuer Rating	Long Term	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3 Cash Credit (Proposed)	Long Term/ Short Term	-	-	-	-	[ICRA]AAA (Stable)

Source: Company,

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Unallocated	NA
Long-term – Issuer Rating	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Unallocated**	NA	NA	NA	100.00	[ICRA]AAA (Stable)
NA	**Issuer Rating**	NA	NA	NA	-	[ICRA]AAA (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Daikin Airconditioning India Private Limited	NA*	Full consolidation
Citizen Industries Private Limited	100%	Full consolidation

*Source: Company, *parent company*

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About ICRA Limited:

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