

August 13, 2019 *Revised*

Daikin Airconditioning India Private Limited: Rating upgraded to [ICRA]AAA (Stable)

Summary of rated action

Instrument*	Current Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit (Proposed)	100.00	100.00	[ICRA]AAA (Stable); Upgraded from [ICRA]AA+ (Positive)
Issuer Rating	-	-	[ICRA]AAA (Stable); Upgraded from [ICRA]AA+ (Positive)
Total	100.00	100.00	

*Instrument details are provided in Annexure-1

Rationale

The rating revision is driven by Daikin Airconditioning India Private Limited's (DAIPL) strong increase in revenues, at a compound annual growth rate (CAGR) of 17%, during FY2016-FY2019, on account of robust domestic demand. The growth was supported by DAIPL's diversified product portfolio and strong position in the Heating, Ventilation, and Air Conditioning (HVAC) industry. This was also accompanied with expansion in its operating margins in FY2019, due to its focus on indigenous manufacturing and better absorption of overheads, leading to strong improvement in cash accruals. The growth momentum is expected to continue in the near to medium term, given the positive demand prospects for the Indian room air-conditioning (RA) industry due to limited penetration. ICRA's ratings also draw comfort from DAIPL's strong business linkage with its parent company, Daikin Industries Limited (DIL;¹ rated A2 with Stable outlook by Moody's). ICRA notes that India is an important market for DIL and thus DAIPL has a high strategic importance for the parent company. This ensures access to technology and the marketing expertise of the parent company, which has a diversified global footprint, with strong position in major markets. DIL's focus on emerging markets such as India, Bangladesh, Nepal, Sri Lanka and Africa, will further strengthen its commitment towards DAIPL, as the latter would act as the manufacturing hub for serving these countries. This would ensure long-term revenue visibility for DAIPL as the growth potential in these market is also strong.

ICRA has also favourably factored in the company's state-of-the-art manufacturing facility and R&D centre in Neemrana, Rajasthan with a capacity to produce 1.5 million units of RAs annually. Its strong manufacturing base in India with increasing localisation would help to partially mitigate the impact of volatility in the foreign exchange rates and upward revision in the import duty on imported raw materials. ICRA's ratings also factor in DAIPL's strong market position in the Indian AC market, with a strong brand and its reputation for high-end energy-efficient products such as inverters, ACs and variable refrigerant volumes (VRVs), supported by an assorted product profile. ICRA has also taken cognisance of the company's strong and expanding pan-India distribution network, and its ongoing efforts to penetrate new geographies for exports.

¹ Daikin Industries Limited (DIL), a Japanese company and global leader in the air conditioning industry.

The rating strengths are partially offset by the intense competition in the Indian AC market, volatility in volumes due to weather conditions and the vulnerability of the company's profitability to adverse movement in exchange rates, though the hedging by DA IPL, of about 60-70% of the foreign currency exposure through forward contracts, reduces the forex risk to a large extent. This apart, the import dependence is also likely to reduce due to the company's capital expenditure plan in the near term for the existing manufacturing facility and also a new manufacturing facility with a capacity of 1.5 million ACs. While the capex is sizeable, internal cash generation from the business is expected to be sufficient for the proposed capital expenditure.

Going forward, the operating and financial performance of DA IPL, as well as any action on the parent's credit rating, will be the key rating sensitivities. The timely execution of capacity expansion plan and returns from the proposed investments for additional capacity will also be monitored closely.

Outlook: Stable

The Stable outlook reflects ICRA's expectation that DA IPL will maintain its market position in India and will have close integration with its parent company. The company is expected to maintain its near debt-free status in the near to medium term, which coupled with healthy cash accruals and cash balances, will support its credit profile. The outlook may be revised to Negative if there is a sustained elongation in the company's working capital cycle or if there is an adverse action on the ratings of the ultimate holding company. Any major debt-funded capital expenditure will also be a key monitorable.

Key rating drivers

Credit strengths

Strong parentage with 99.99% stake of Daikin Industries Limited (DIL, Japan) – DA IPL has strong relationship with DIL (its parent company), in terms of transfer of technology, know-how, key raw materials, etc. DIL also has a representation in the board of directors of DA IPL and provides regular training to the employees of the latter.

Strong market presence with healthy market share in the RA industry in India – DA IPL has a sizeable market share in the Indian RA industry as of FY2019. The company's top-line growth remained robust in the past couple of years. It remains the market leader in the VRV segment in FY2019, while it maintains a healthy market share in the inverter RAs.

Widespread dealer network across India and aggressive marketing efforts support top-line growth – DA IPL has a sales and distribution network of over 6,000 channel partners and 34 warehouses including 5 mother warehouses. The company has over 600 service partners and over 400 Daikin Solution Plazas (exclusive showrooms).

Favourable financial profile with unlevered capital structure, comfortable liquidity with efficient working capital management – DA IPL's financial profile remains healthy with unlevered capital structure and comfortable liquidity. The company's healthy cash accruals are expected to keep the liquidity at comfortable levels in the near to medium term.

Favourable outlook for India's AC industry given the low penetration – The increasing urbanisation, climate change and rising standard of living are fast making ACs a requirement across India. However, the segment is still considered one of the least penetrated consumer durable segments, with about 6% penetration of the total market.

Credit challenges

Cyclical demand and dependence on other variables such as urban and rural electrification – The demand for RAs is also dependent on real estate activities, availability of electricity, and upfront cost of acquisition. All these factors could restrict the volume growth in the near to medium term.

Susceptibility to weather conditions – Sales volumes are susceptible to weather conditions as well as the inherent seasonality in the business due to intensity of summer.

High import dependence; proposed capital expenditure plan to help reduce the import reliance – DAIPL imports 49% of its raw material requirement. Hence, high import dependence exposes the company’s profitability to exchange rate volatility. To reduce this dependence, DAIPL has a capex plan of more than ~Rs. 1,000 crore (including approximately Rs. 700 crore for the new manufacturing facility) over the next five years. The timely execution of the proposed expansion plan will help in reducing its import dependence and also help insulate it from the impact of foreign currency volatility and adverse import duty changes (hike in import duty on imported compressor or ACs).

Liquidity position

DAIPL’s financial flexibility is strong due to its unlevered capital structure. This apart, the company has healthy cash and cash equivalents of ~Rs. 206 crore as on March 31, 2019. Its cash generation has remained strong and is expected to remain healthy going forward. The company has major capital expenditure planned in the near to medium term. However, this would be funded from the internal accruals of the business. The current ratio remained healthy at 1.91 times in FY2019.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Issuer Rating—A Note On Methodology Impact of Parent or Group Support on an Issuer’s Credit Rating
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financials of DAIPL

About the company

Daikin Airconditioning India Private Limited (DAIPL), a wholly-owned subsidiary of Daikin Industries Limited, is involved in manufacturing and selling RAs, VRVs, and chillers under the Daikin brand. DAIPL was incorporated in April 2000 as a joint venture (JV) between DIL and SIEL Limited, with DIL holding an 80% stake in the JV. Later, DIL acquired a 100% stake in the company and it became a wholly-owned subsidiary of DIL. Initially, DAIPL serviced the Indian market through imports from Daikin’s facilities in Japan, Thailand and Malaysia. In 2009, the company commenced production at its manufacturing unit at Neemrana, Rajasthan, with the production of chillers. Later, it started manufacturing VRVs and HFC-32 refrigerant high wall split ACs and packaged ACs at its plant. The manufacturing plant is spread across 40 acres and has around 3,500 employees as of July 2019. Currently, the company has a sales and distribution network of over 6,000 dealers and a few warehouses. In addition, it has over 600 service partners and over 400 Daikin Solution Plazas. The company plans to double its manufacturing capacity in the next five years, with the new capacity scheduled to commence operations in a phased manner in next five years at another location.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	3194.3	3652.4
PAT (Rs. crore)	150.3	191.9
OPBDIT/OI (%)	8.8	10.2
RoCE (%)	26.4	27.3
Total Debt/TNW (times)	0.0	0.0
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	5.9	7.5

Source: Audited annual reports

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		
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating August 2019	Date & Rating in	Date & Rating in	Date & Rating in
					FY2019 October 2018	FY2018 August 2017	FY2017 September 2016
1 Cash Credit (Proposed)	Long Term	100.00	-	[ICRA]AAA (Stable)	[ICRA]AA+ (Positive)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2 Issuer rating	Long Term	-	-	[ICRA]AAA (Stable)	[ICRA]AA+ (Positive)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)

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	Cash Credit (Proposed)	NA	-	NA	100.00	[ICRA]AAA (Stable)
NA	Issuer Rating	-	-	-	-	[ICRA]AAA (Stable)

Source: DAIPL

Annexure-2: List of entities considered for consolidation - Not applicable

Annexure-3: Corrigendum

Rationale dated August 13, 2019 has been corrected with revision as detailed below:

There is a change (removal) in the analytical approach table on page number no 3

“ICRA expects DA IPL's parent, DIL, to extend operational and financial support to DA IPL, should there be a need; DA IPL has strong business linkages and shares a common name with its parent company; moreover, India is an important market for DIL and thus DA IPL has a high strategic importance for the parent company”.

There is a change (insertion) in the rationale section (paragraph first) on page no 1

“ICRA's ratings also draw comfort from DA IPL's strong business linkage with its parent company. ICRA notes that India is an important market for DIL and thus DA IPL has a high strategic importance for the parent company. This ensures access to technology and the marketing expertise of the parent company, which has a diversified global footprint, with strong position in major markets.”

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