January 28, 2022

Daikin Airconditioning India Private Limited: Ratings reaffirmed at [ICRA]AAA (Stable)

Summary of rating action

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

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation continues to take into account Daikin Airconditioning India Private Limited's (DAIPL) strong business risk profile, with a diversified product portfolio within the air conditioning (AC) segment and strong position in the heating, ventilation, and air conditioning (HVAC) industry. This is further supplemented by its healthy financial risk profile, reflected by its debt-free status and a superior liquidity position. ICRA's ratings also derive comfort from DAIPL's strong business linkages with its parent company, Daikin Industries Limited (DIL;[1] rated A2 with Stable outlook by Moody's).

DAIPL's operating income (OI) de-grew by 16% in FY2021 due to the Covid-19 pandemic related lockdown in metros, tier-I and II cities, which led to a closure of retail outlets and dampened the consumer sentiment significantly in Q1 FY2021—the peak season for the AC industry. The top-line growth was also accompanied by margin contraction in FY2021. However, the company witnessed revival in 9M FY2022 and expects to achieve revenues of pre-Covid levels for the full year FY2022. Price hikes and cost rationalisation measures during the second wave of the pandemic are expected to negate the impact of input cost rises to a large extent, resulting in range-bound margin for the year.

ICRA's rating continues to derive comfort from DAIPL's strong market presence and increasing market share in the AC industry. DAIPL has a strong market position in the Indian AC market, with a strong brand and a reputation for high-end energy-efficient products, such as inverter ACs and variable refrigerant volumes (VRVs), supported by an assorted product profile and widespread distribution network. The company's growth momentum is expected to continue in the medium term, given the positive demand prospects for the Indian room air-conditioning (RAC) industry due to limited penetration. ICRA has also favourably factored in the company's state-of-the-art manufacturing facility and research and development (R&D) centre in Neemrana, Rajasthan, and proposed integrated manufacturing facility at Sri City, Andhra Pradesh. Its strong manufacturing base in India with increasing localisation would help to partially mitigate the impact of volatility in the foreign exchange (forex) rates and the risk of an upward revision in the import duty on raw materials.

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. DAIPL's focus on emerging markets such as Africa and West Asia, in addition to domestic demand, would ensure long-term revenue visibility for DAIPL as the growth potential in these markets is also strong.

The rating strengths are partially offset by the intense competition in the Indian AC market, volatility in sales volume due to change in weather conditions and the vulnerability of the company's profitability to adverse movement in exchange rates. However, DAIPL hedges most of its foreign currency exposure through forward contracts, thereby reducing the forex risk to a

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

large extent. In addition, the import dependence is likely to reduce with the execution of the company's capital expenditure (capex) plan, which envisages capacity expansion in the near term at its existing manufacturing facility and a new manufacturing facility with a production capacity of 1.5 million RACs along with AC components, such as compressors, heat exchangers, and cross-flow fans, among others. While the capex is sizeable, 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 expectation that DAIPL will maintain its market position in India and enjoy close integration with its parent. The company is expected to maintain its near debt-free status in the near to medium term, which coupled with healthy cash accruals and superior liquidity, will support its credit profile.

Key rating drivers and their description

Credit strengths

Strong parentage with 99.99% stake of DIL, Japan – DAIPL enjoys a strong relationship with DIL in terms of transfer of technology, know-how, key raw materials, etc. DAIPL also has a representation in DIL's board of directors. It is strategically important for DIL as it is planned as a key supplier to other geographies and also expected to play a key role in DIL's R&D efforts. DIL's plan to make India a manufacturing hub for its key markets, which include India, other South Asian countries, Africa and West Asia. India and Latin America are the focus regions for DIL under its 'Fusion 25' global growth strategy. DIL is the global leader in the AC business with the highest market share and presence in more than 160 counties and 315 subsidiaries. DIL has a strong operational and financial profile and is expected to provide operational, technological and financial support to DAIPL, as and when needed.

Strong market presence with healthy market share in India's RAC and VRV industries – 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 FY2021 due to the pandemic. It remains the market leader in the VRV segment and maintains a healthy market share in inverter RAs. The technological support from its parent gives DAIPL an edge over its competitor in new technology innovation and product launch. DAIPL is largely ahead of its peers in adopting global norms and new technology.

Pan Indian dealership network and aggressive marketing efforts support top-line growth – DAIPL has a sales and distribution network of over 8,000 channel partners and 31 warehouses, including seven central and mother warehouses. The company has over 600 service partners and over 400 Daikin Solution Plazas (exclusive showrooms). The company derives maximum revenue from the dealers and distributors channel, followed by regional and national retail chains, Daikin Solutions Plazas, e-commerce platforms, AC and consumer durable dealers.

Favourable financial profile with unleveraged capital structure, strong liquidity and efficient working capital management – DAIPL's financial profile remains healthy with an unleveraged capital structure. The company's healthy cash accruals are expected to keep the liquidity at comfortable levels in the near to medium term. Its liquidity position is superior due to healthy cash and cash equivalents, and fully unutilised working capital limits. The company also has efficient working capital management with modest level of debtors and inventory, which are internally funded. The company has embarked on a large sized capex plan of ~Rs. 2,200 crore, which includes capacity expansion and backward integration as well as associated R&D centre over the next 5–7 years. 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 – 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 7% penetration of the total market size.

Credit challenges

Decline in revenue and margins in FY2021 due to pandemic-related lockdown and input cost rises – DAIPL's revenues and profitability declined in FY2021 as expected, due to a subdued performance in Q1 FY2021 from the closure of retail outlets, disruption of manufacturing operations and reduced consumer confidence during the pandemic. However, the company has reported healthy revenue growth in 9M FY2022 on account of healthy domestic demand. The margins are likely to remain stable in FY2022 owing various cost rationalisation measure and price hike of final products to negate the rise in input cost. The input cost had increased due to various reasons such as a rise in copper and aluminium cost, the availability issue of semiconductors, increased import duty on R-32 refrigerant and high transportation cost, among others.

Cyclical demand and dependence on other variables such as rural electrification and real estate activity – The demand for RAs is also dependent on real estate activities, availability of electricity, especially in rural areas. Sales volumes are susceptible to changes in weather conditions. There is also an inherent seasonality in the business due to the intensity of Indian summers. All these factors could restrict volume growth in the near to medium term.

High import dependence; exposure to forex risks – DAIPL imports ~35% of its raw material requirement from group companies and other suppliers, which exposes it to forex and price volatility risks. However, the company hedges ~80-90% of its forex transactions. Moreover, the proposed capex plan would reduce the import dependency to a large extent.

Liquidity position: Superior

DAIPL's liquidity position is **superior** due to its unleveraged capital structure, substantial unutilised working capital limits and healthy cash and cash equivalents as of December 2021. Its cash generation has been strong in the past and is expected to remain healthy, going forward.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Negative pressure on DAIPL's rating could arise if there is a sharp deterioration in the company's earnings, or in case there is any major debt-funded capex weakening its credit metrics. The ratings could also be downgraded in case 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 Rating Approach – Implicit Support from Parent or Group
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 Limited (CIL).

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. DAIPL was incorporated in April 2000 as a joint venture (JV) between DIL and SIEL Limited. 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 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 proposed a capex plan to double its finished goods capacity, backward integrate into manufacturing AC components from Sri City, and develop an additional R&D centre at Neemrana with a total project cost of ~Rs. 2,200 crore to be spread over the next five to seven years. The investment in component manufacturing has been covered under the Government of India's production linked incentive

(PLI) scheme to the tune of Rs. 538.7 crore, which is 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.

Key financial indicators (audited)

DAIPL – Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	4,005.2	3,381.5
PAT (Rs. crore)	232.4	145.6
OPBDIT/OI (%)	12.7%	10.8%
PAT/OI (%)	5.8%	4.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.7x	0.9x
Total Debt/OPBDIT (times)	0.1x	0.1x
Interest Coverage (times)	8.0x	14.0x

Source: Company

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore) *	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Jan 28, 2022	Nov 30, 2020	Aug 13, 2019	Oct 9, 2018
1	Unallocated	Long Term	100.00	-	[ICRA]AAA (Stable)	-	-	-
2.	Issuer Rating	Long Term	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AA+ (Positive)
3.	Cash Credit (Proposed)	Long Term	-	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)

Source: Company

Complexity level of the rated instrument

Instrument Name	Complexity Indicators
Long Term – Unallocated	NA
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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/ Lender Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	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-2: List of entities considered for consolidated analysis

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

*Source: Company, *parent company*

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545 328
shamsherd@icraindia.com

Kinjal Shah
+91 22 6114 3442
kinjal.shah@icraindia.com

Sheetal Sharad
+91 124 4545 374
Sheetal.sharad@icraindia.com

Uday Kumar
+91 124 4545 867
uday.kumar@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

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ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches