April 06, 2023

Daikin Airconditioning India Private Limited: Ratings 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 ratings reaffirmation reflects ICRA's expectations that Daikin Airconditioning India Private Limited (DAIPL) will maintain a strong business risk profile with a strong position in the air conditioning industry particularly in the room airconditioning (RACs) and variable refrigerant volumes (VRV) segments. Moreover, the company is expected to maintain a healthy financial risk profile, reflected in its debt-free status and a strong liquidity position. ICRA's ratings continue to 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 has a strong market position in the Indian AC market, with a strong brand presence supported by an assorted product profile and widespread distribution network. DAIPL's operating income (OI) grew by ~43% in FY2022 led by strong demand after the Covid-19 pandemic-related disruptions in FY2021. Moreover, the company witnessed healthy growth in OI in FY2023 as well supported by strong sales volumes in the backdrop of a harsh summer. 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 due to the increasing penetration with growing ACs per household, rising urbanisation and disposable income as well as weather changes. Moreover, ICRA notes that India is an important market for DIL and thus, DAIPL has a high strategic importance for it. In addition to growing Indian demand, DAIPL is expected to cater to various exports where DIL has presence, 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 movements in input costs as ability to pass on large price increases in a competitive market remains limited, which is reflected in decline in OPM in FY2022 and 9M FY2023. Moreover, changes in regulations and energy efficiency standards can impact the company's cost structure. This apart, the company has a sizeable ongoing capex plan, as per which it is setting up a manufacturing facility at Sri City Andhra Pradesh. The company's ability to successfully commission the project and achieve desired backward integration benefits remains crucial. In addition, the company has import dependence for various components which exposes it to forex fluctuations and supply-side shocks. However, the same is likely to reduce after the commencement of the Sri City facility which will be producing AC components, such as compressors, heat exchangers, and crossflow fans, etc. 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 expectations that DAIPL will maintain its market position in India and enjoy the close integration with its parent. The company is expected to maintain its near debt-free status and strong liquidity profile, which will continue to support its strong financial profile.

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

Key rating drivers and their description

Credit strengths

Strong parentage with 99.99% stake of DIL, Japan; strong operational and financial linkages with DAIPL – DAIPL enjoys a strong relationship with DIL in terms of transfer of technology, 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 planned as a key supplier to other geographies and also 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 has a strong operational and financial profiles and is expected to provide operational, technological and financial support to DAIPL. DAIPL procures key components from DIL, which include compressors among others. This apart, DIL also provides funding support in the form of equity infusion 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 and increasing market share in inverter RACs. The 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 of over 12000 touch points. 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. DAIPL's OI grew significantly in FY2022 and 10M FY2023, led by strong demand after the Covid-19 pandemic-related disruptions in FY2021.

Favourable financial profile with unleveraged capital structure, strong liquidity and efficient working capital management – DAIPL's financial profile remains healthy with growing cash accruals on the back of healthy volumetric growth and growing realisations even as margins witnessed some pressure. The company continues to have an unleveraged capital structure and strong coverage metrics. Its liquidity position is strong due to healthy cash and cash equivalents, and fully unutilised working capital limits. The company also has efficient working capital management with a modest level of working capital intensity, which is 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 an associated R&D centre for FY2022-FY2025. 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, 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 the volatile raw material prices, reflected in the moderation in OPM in FY2022 and 10M FY2023. The prices of the key raw materials remained elevated in FY2023 after a sharp increase in FY2022. DAIPL has adopted the new star label in January 2022 mandated by the Government, which has also increased manufacturing costs. However, the company has taken price rise across product categories in FY2022 and FY2023, which has mitigated the impact of the rise in input cost to an extent. Going forward, DAIPL's margins are likely to remain range bound.

Large capex undergoing, timely commencement of production crucial – DAIPL is undertaking a large capex of ~Rs. 2,200 crore, which is to be completed by FY2025. The capex is related to doubling the existing installed capacity and backward integration towards component manufacturing such as compressor, motor, heat exchanger, plastic moulding, etc. The company has plans to commence commercial production in a phased manner starting from July 2023. Hence, the timely commencement of commercial production remains crucial for sustaining 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 ~40-45% of its raw material requirement, out of which ~30-35% from the Group companies, which exposes it to forex, price volatility and supply-side shocks. However, the company hedges ~90-95% of forex exposure. Moreover, the company plans to commence commercial production of AC components in the current year, which is expected to lead to decline in import dependency gradually.

Liquidity position: Strong

DAIPL's liquidity position is **strong,** due to substantial unutilised working capital limits (nil utilisation against Rs. 830 crore of cash credit limit during the 12-month period ended in February 2023) and healthy cash and cash equivalents of Rs. 230 crore as of February 2023. Its cash flow from operations has been strong in the past and is expected to remain strong, going forward as well. The company has planned capex of ~Rs. 2,200 crore for FY2022-FY2025, which is being funded through internal accruals, existing cash and equity from parent. The company has already received Rs. 500 crore equity from DIL in FY2023.

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 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 – Consolidation
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 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. 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.

Key financial indicators (audited)

DAIPL consolidated	FY2021	FY2022	10M FY2023*
Operating income	3,381.5	4,834.7	5233.7
PAT	145.6	231.0	218.0
OPBDIT/OI	10.8%	9.5%	-
PAT/OI	4.3%	4.8%	-
Total outside liabilities/Tangible net worth (times)	0.9x	0.9x	-
Total debt/OPBDIT (times)**	0.1x	0.2x	-
Interest coverage (times)	14.1x	15.4x	-

*Source: Company, *provisional financials submitted the company, **debt mainly includes lease liabilities*

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. Crore,

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore) *	Date & rating in FY2024	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					April 6, 2023	Jan 28, 2022	Nov 30, 2020	Aug 13, 2019
1	**Unallocated**	Long Term	100.00	-	[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)	[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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