June 30, 2022

Padget Electronics Pvt. Ltd.: Ratings Reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Term Loan	55.00	55.00	[ICRA]AA-(CE)(Stable)^; reaffirmed
Non-fund Based - Working Capital Facilities	155.00	155.00	[ICRA]A1+(CE)^; reaffirmed
Total	**210.00**	**210.00**	
Rating Without Explicit Credit Enhancement			**[ICRA]A- / [ICRA]A2+**

**Instrument details are provided in Annexure-1*

^Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. This rating is specific to the rated instrument/facility, its terms and its structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The last row in the table above also captures ICRA's opinion on the rating without factoring in the explicit credit enhancement.

Rationale

The [ICRA]AA-(CE) (Stable) rating for Rs. 55.0 crore term loan facility and [ICRA]A1+(CE) rating for Rs. 155.0 crore non-fund based facilities of Padget Electronics Pvt. Ltd. (PEPL) is based on credit enhancement in the form of unconditional and irrevocable corporate guarantee from Dixon Technologies India Limited (DTIL; rated at [ICRA]AA-(Stable)/[ICRA]A1+).

Adequacy of credit enhancement

For the above ratings, ICRA has assessed the attributes of the corporate guarantee provided by DTIL for the rated bank facilities of PEPL. The guarantee is unconditional and irrevocable and covers the entire amount and tenure of the rated facilities, though it does not have a well-defined invocation and payment mechanism. Given these attributes, the guarantee provided by DTIL is adequately strong to result in an enhancement in the rating of the said instruments to [ICRA]AA-(CE)/[ICRA]A1+(CE) against the rating of [ICRA]A-/[ICRA]A2+ without explicit credit enhancement.

In case the ratings of the guarantor or the unsupported rating of PEPL undergo a change in the future, the same would have a bearing on the ratings of the aforesaid facilities. The ratings may also undergo a change if, in ICRA's assessment, there is weakening in the business or financial linkages between DTIL and PEPL.

Salient covenants of the rated facility

- *Any loans from the guarantor to the borrower will be subordinated to the indebtedness of the borrower to the bank.*

The ratings note the strong parentage of PEPL and the strength of its operational linkages with the parent entity—DTIL—which has an established track record of operations in the electronics manufacturing services (EMS) sector. The ratings consider PEPL's operational track record of over six years in the mobile manufacturing business. Further, the ratings derive comfort from the license received by the company as a domestic manufacturer of mobile phones under the production linked incentive (PLI) scheme launched by the Government of India (GoI), which is expected to support it in scaling up and adding new clients.

The ratings are, however, constrained by the susceptibility of its performance to the business plans and performance of its clients. ICRA notes that PEPL has achieved the dual targets of incremental investment and incremental sales for Year 1 making it eligible for the incentive subject to audit by the authorities. The ratings factor 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. PEPL, like other electronics manufacturers, has high dependence on imported raw materials/components and is susceptible to any significant supply-chain disruption. In this context, ICRA factors in the shortage in global supply chain of semiconductors, an important component of electronics products. The impact of the same of sales volumes and profitability will be a key rating monitorable. The ratings also note the company's highly leveraged capital structure, which has increased due to the debt-funded capex incurred over the last one year.

The Stable outlook on the rating reflects ICRA's expectation that PEPL will benefit from the strength of its operational linkages with DTIL and benefits under the PLI scheme.

Key rating drivers and their description

Credit strengths

Corporate guarantee from DTIL and strong linkages offer comfort – PEPL is a wholly-owned subsidiary of DTIL, which is one of the largest electronics contract manufacturers in the country with a track record of over three decades in the business. DTIL has extended a corporate guarantee for the company's bank facilities.

Healthy track record of operations as manufacturer of mobile phones for domestic and global brands – PEPL has a six-year track record of operations in manufacturing mobiles phones for domestic and global brands. Panasonic and Gionee were initially the company's largest clients, but the client mix has changed over the years. At present, Motorola is the largest customer (accounting for 75% of revenue), followed by Karbonn (accounting for 7% of revenue) and Nokia (constituting 5% of revenue).

Licensed manufacturer under GoI's PLI scheme – PEPL is licensed as a domestic manufacturer of mobile phones under the PLI scheme launched by the GoI. The benefits under the scheme has helped the company to enter into manufacturing agreements with large brands. However, the company's eligibility to receive incentives under the PLI scheme depends on its ability to meet the dual targets of cumulative investment and cumulative sales as specified under the scheme and therefore, the same will remain a key rating monitorable. PEPL has made significant investment in FY2022 and has scaled up sharply, which is expected to help it in meeting the eligibility threshold for incentive in terms of incremental investment and incremental sales.

Credit challenges

Moderate scale of operations compared to industry size – While the company's scale has increased, it remains relatively moderate in comparison to the leading players in the mobile phone manufacturing business. Mobile phone manufacturing in India is currently dominated by contract manufacturing partners of global brands that have set up production facilities in the country. However, the PLI scheme is expected to boost the competitive ability of the domestic manufacturers as the incentives would provide an impetus to the brands to source manufacturing of sub-Rs. 10,000 smartphones from the domestic manufacturers.

Client concentration risk and dependence on principals' business plans and performance – As is prevalent in the industry, the company's revenues are closely linked to the business plan and performance of its principals. In the past, PEPL's top line growth was affected by the declining market share of its key principals. Further, it faces revenue concentration risk, as the top three clients accounted for 87% of the revenues in FY2022.

Competition and risk of technological obsolescence necessitates continuous upgrade of processes and products – The consumer durable/electronic products/EMS 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. These limit its pricing flexibility and bargaining power with customers, thereby putting pressure on the profit margins. The competition has increased following the entry of globally competitive contract manufacturing players in the domestic market in the recent years. Further, PEPL is vulnerable to risks pertaining to regulatory changes (like custom duty, taxation, etc) and foreign exchange exposure, considering its sizeable imports. However, the forex risk is abated to an extent with its ability to pass on the variation.

Leveraged capital structure – PEPL's leverage has increased due to sizeable debt-funded capex. The debt to net worth has increased to 4.5 times in FY2022 from 2.8 times in FY2021. Driven by the expansion in its scale of operations, its working capital position – both receivables, inventory, and creditors have increased sharply with a TOL/TNW ratio to 17.6 times as on March 31, 2022. However, the company has a back-to-back arrangement with its suppliers, wherein the conversion period for inventory and bill realisation is provided by the creditors, which reduces the risk related to high TOL.

Liquidity position: Adequate

For the CE rating – Adequate

This is supported by DTIL's adequate liquidity position and the credit enhancement extended in the form of corporate guarantee.

For rating without explicit credit enhancement – Adequate

PEPL had a cash balance of Rs. 50.9 crore as on March 31, 2022, which provides adequate liquidity comfort. This shall be supported by the company's robust growth expected to generate sufficient cash to service its debt servicing commitments in the future. Further, linkages with a strong sponsor provides additional financial flexibility.

Rating sensitivities

Positive factors – The rating maybe upgraded if there is an improvement in the credit profile of the parent entity.

Negative factors – The rating may be downgraded in a scenario where, in ICRA's assessment, there is a deterioration in the credit profile of parent (DTIL) or if there is weakening in the business or financial linkages between DTIL and PEPL. The rating maybe be downgraded if the operational profile of PEPL weakens due to lower-than-expected ramp-up in production or if working capital issues result in weakening of credit metrics.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Impact of Parent or Group Support on an Issuer's Credit Rating Approach for rating debt instruments backed by third-party explicit support
Parent/Group Support	Parent/Group Company: Dixon Technologies (India) Limited (DTIL) The assigned CE rating factors in the irrevocable and unconditional corporate guarantee provided by DTIL for the bank facilities of PEPL; the rating also factors in the likelihood of its parent, DTIL, extending financial support to PEPL, given the close operational linkages and the strategic importance of PEPL's operations for the Group's growth
Consolidation/Standalone	The rating is based on the standalone financial statements of the issuer

About the company

Padget Electronics Pvt. Ltd. (PEPL) is a 100% subsidiary of DTIL, which manufactures/assembles mobile handsets. Its manufacturing plant is located in Noida; it started production of mobiles in November 2015. The company was initially established as joint venture between DTIL and the Jaina Group (owners of the Karbonn brand) in 2013. DTIL, on April 12, 2019, acquired the balance 50% equity share of PEPL from Mr. Pradeep Jain (holding ~47% shares of PEPL on March 31, 2019) and other Jaina Group companies (holding ~3% shares of PEPL on March 31, 2019) for Rs. 27 crore in an all-cash deal.

An application made by PEPL for license as a domestic manufacturer of mobile phones under the PLI scheme of the GoI was accepted in October 2020. The company has entered into manufacturing agreement with global brands. It plans to undertake capex for the same, a part of which will be debt funded.

In FY2022, the company reported a net profit of Rs. 28.7 crore on an operating income (OI) of Rs. 2,960.1 crore (provisional) compared to a net profit of Rs. 3 crore on an OI of Rs. 753.6 crore in the preceding year.

Key financial indicators (audited)

PEPL	FY2020	FY2021
Operating Income (Rs. crore)	516.8	753.6
PAT (Rs. crore)	9.1	3.0
OPBDIT/OI (%)	2.7%	1.3%
RoCE (%)	28.5%	6.0%
Total Outside Liabilities/Tangible Net Worth (times)	2.7	7.7
Total Debt/OPBDIT (times)	-	13.0
Interest Coverage (times)	-	4.6

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year);
Source: PEPL

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					June 30, 2022	Mar 17, 2021	-	-
1	Fund-based -Term Loan	Long Term	55.00	41.25	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)	-	-
2	Non-fund Based - Working Capital Facilities	Short Term	155.00	-	[ICRA]A1+(CE)	[ICRA]A1+(CE)	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund-based -Term Loan	Simple
Non-fund Based - Working Capital Facilities	Very Simple

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: 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	Feb 14, 2020	NA	Feb 28, 2025	55.0	[ICRA]AA-(CE) (Stable)
NA	Non-fund Based - Working Capital Facilities	NA	NA	NA	155.0	[ICRA]A1+(CE)

Source: PEPL

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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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.

For more information, visit www.icra.in

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