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India Ratings Downgrades OPPO Mobiles India and its NCDs to 'IND BB-'; Outlook Stable

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India Ratings and Research (Ind-Ra) has downgraded Oppo Mobiles India Private Limited's (OPPO) Long-Term Issuer Rating to 'IND BB-' from 'IND BB'. The Outlook is Stable. The instrument-wise rating actions are given below:

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Non-convertible debentures (NCDs)	INE793V08021*	30 September 2016	3	30 September 2020	INR7	IND BB-/Stable	Downgraded

*The ISIN Code has been updated to reflect OPPO receiving approvals from all relevant regulatory authorities to extend the maturity date of its outstanding NCD to 30 September 2020 from 30 September 2019.

The downgrade reflects deterioration in the financial profile of OPPO, with margins remaining negative and losses increasing. Furthermore, heightened competition in the sector could continue to put pressure on the cash flows, leading to uncertainty in regards to future debt servicing.

KEY RATING DRIVERS

Continued Losses: OPPO's weak financials are reflected by an EBITDA loss of INR11 billion in FY19 (FY18: loss of INR5.3 billion), and a net loss of INR6.9 billion (INR3.6 billion). The continued loss is despite 80% yoy improvement in revenue to INR215 billion in FY19, due to increased demand and product launches. The company's operating margins deteriorated to negative 5.1% in FY19 (FY18: negative 4.4%) due to increased cost of raw materials, which are typically imported from China. The company faced a major forex loss of INR6.5 billion in FY19 (FY18: loss of INR255 million). If EBITDA and net income were to be adjusted for the same, the company's margin be relatively better at negative 2.1% (FY18: negative 4.2%), and there would be a marginal net loss of INR364 million (FY18: net loss of INR3.3 billion).

The company will look to turn profitable in FY21 by increasing sales through product launches at more competitive price-points, developing innovative products (under-display finger print scanner) and strengthening its offline presence. The management, however, has indicated that it would continue to spend sizeable amounts (7%-10% of revenue) on sales promotions to maintain its current market share.

Liquidity Indicator - Poor: Ind-Ra expects the company to continue to incur EBITDA losses till FY21 on account of thin gross margins and high advertisement expenses, thus remaining vulnerable to refinancing risk. The company has been able to meet its interest payments via its cash balances (FY19: INR9.3 billion, FY18: INR10.8 billion), but it is reliant on the parent to repay its upcoming NCD, due in September 2020. Furthermore, internal cash flows are volatile, and cannot be relied upon.

The company's debt structure has no bank debt, and comprises an NCD worth INR7 billion and an ECB of INR17.3 billion, both of which are subscribed by OPPO's parent entity. The external commercial borrowing will be due in FY24. Given the company's weak financial performance, reliance on high cash balances and funding of its working capital cycle through its trade payables, the company has committed that it will make its large principal repayments through further funding from the parent entities.

Large Capex Impacts Cash Flows: OPPO incurred capex of INR9.3 billion in FY19 (FY18: INR3.2 billion) to expand the capacity and manufacturing capabilities at its two facilities (Surajpur and Kasna, Greater Noida). Cash flow from operations turned negative to INR8.3 billion in FY19 (FY18: INR9 billion) on account of increased inventory, leading to net working capital increasing to negative 49 days (FY18: negative 83 days; FY17: negative 71 days). This led to a working capital inflow of roughly INR1.1 billion in FY19, much lower than historical working capital inflows (FY18: INR14.3 billion; FY17: INR5.8 billion), as the company continued to extend its trade payables. The agency expects the inventory level to moderate in FY20 (FY19: INR14.5 billion, FY18: INR3.8 billion), as the company tends to stock large quantities of raw materials six months prior to the launch of new products.

Shift in Strategy; Stable Market Share: OPPO's shipment market share has remained stable at roughly 10% over the last one year, due to the combined effect of its aggressive marketing strategy and a shift in the company's strategy. The company has reduced the margins offered to retailers and rationalised its distribution. Thus, its products are now available at fewer counters which have strong visibility and sales. However, strong marketing from competitors has meant the company's market share has remained stable. As of July 2019, the company's market share stood at 8% (2Q18: 9%).

Ind-Ra expects to see improvement in OPPO's margins in the medium term, which will enable it to make focused investments in tier two- and three- tier cities. Management expects to achieve major revenue growth in FY20 on account of new product launches and improved focus on online and offline sales, thus growing its market share in the process.

Domestic Manufacturing to Increase: Assembling capacity of the company increased to 65 million units in FY19 (FY18: 15 million units). The company had commissioned a greenfield facility in Greater Noida to cater to the additional demand arising from the Indian market. A domestic manufacturing facility with capacity of 50 million units was operational in FY19. The company now has enhanced connectivity with its dealers given the location of the facility and will be able to keep pace with the growing Indian smartphone market.

Forex Risk; Intense Competition: The company imports over 95% of its material requirements, which exposes it to foreign exchange fluctuation risk. Also, intense competition leaves less flexibility to pass on price increases to customers. However, the risk is partially mitigated by increasing the mix of indigenous sourcing/manufacturing. The company is increasing local manufacturing of printed circuit boards, which make up around 50% of the smartphone's making cost, which would reduce the impact of rupee depreciation.

Industry Risks: The ratings factor in industry risks such as rapid technological changes, changing consumer preferences and competitive pricing pressures.

RATING SENSITIVITIES

Positive: A sustained improvement in the overall financial risk profile could be positive for the ratings.

Negative: Sustained deterioration in the overall financial risk profile could be negative for the ratings.

COMPANY PROFILE

Incorporated in November 2013, OPPO is engaged in manufacturing and selling of smartphones and wholesale trading of mobile spare parts and accessories.

FINANCIAL SUMMARY

Particulars	FY19	FY18
Operating Revenue (INR billion)	215.2	119.9
EBITDA (INR billion)	-11.0	-5.3
Operating EBITDA margin (%)	-	-
Interest expenses (INR billion)	0.38	0.21
Total adjusted debt (INR billion)	24.3	7.0
Source: Ind-Ra, OPPO		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	9 August 2018	15 June 2017	10 October 2016
Issuer rating	Long-term	-	IND BB-/Stable	IND BB/Stable	IND BB/Stable	IND BB/Stable
NCDs	Long-term	INR7	IND BB-/Stable	IND BB/Stable	IND BB/Stable	IND BB/Stable

COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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Applicable Criteria

Corporate Rating Methodology
Treatment and Notching of Hybrids in Nonfinancial Corporates

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