

Rating Rationale
Worldlink Communications Limited

Rating

| Facility/ Instrument | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|----------------------------|----------------------------|--|---------------|
| Long Term Bank Facilities | 787.18 | CARE-NP A [Single A] | Assigned |
| Short Term Bank Facilities | 1,412.82 | CARE-NP A2+ [A Two Plus] | Assigned |
| Total facilities | 2,200.00 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP A’ to the long term bank facilities and to ‘CARE-NP A2+’ to the short term bank facilities of Worldlink Communications Limited (WCL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of WCL derives strength from strong financial profile of the company in FY20 (audited, refers to 12 months period ended mid-July 2020) characterized by regular growth in revenue and profitability, comfortable capital structure and healthy debt coverage indicators at the end of FY20 with significant improvement from FY19, coupled with long track record of operations and strong brand presence in Internet Service Provider (ISP) industry being the market leader with steady increase in subscriber base in Nepal. The ratings also factor in experienced board & management team, investment from strong institutional shareholder, wide portfolio of services offering revenue visibility, increased efforts for market penetration with latest technology and resources to increase outreach. The ratings are however, constrained by high capital and technology intensive nature of industry, exposure to foreign exchange fluctuation risk with net foreign exchange losses during FY20 and exposure to technology risk associated with ISP business. The ratings also factor in increasing competition in the industry with fragmented market, working capital intensive nature of operations and government policy towards Internet Service Providers.

Ability of the company to maintain the growth in revenue, while improving the profitability margins and maintaining the capital structure are the key rating sensitivities. Also, the ability of the company to withstand the increasingly competitive business environment in internet business and maintain low leverage profile despite higher capital expenditure plans remains the key rating sensitivities. Any debt funded capital expenditure /acquisition impacting the overall financial risk profile of the company also remain the key rating sensitivities.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Strong financial profile in FY20 characterized by regular growth in revenue and profitability

The financial risk profile of the company is comfortable with increase in scale of operations and continuous increase in subscriber base. WCL posted total operating revenue of Rs. 6,545 Mn in FY20 reporting a growth of 30% over FY19. This growth in income is on account of ~23% growth in subscriber base during FY20. Accordingly, PBILDT margin improved to 35.14% in FY20 with increase in profitability on account of growth in revenue, supported by cost advantages arising from economies of scale. During H1FY21, (Un-audited, refers to 6 months period ended mid-July 2021) the company has earned revenue of Rs. 3,751 Mn.

Comfortable capital structure and healthy debt coverage indicators at the end of FY20 with significant improvement from FY19

On account of change in accounting policy adopted by the company from GAAP to NFRS in FY20 with transition date from FY18 onwards, the revenue recognition policy has been changed. Accordingly, the financials for FY18 and FY19 were reinstated and the unexpired/unaccrued revenue together with related costs were directly deducted from the Reserves & Surplus outstanding at the end of FY18 which led to surplus in Profit & loss Account turn negative under NFRS despite earning profits during the year. With equity infusion into the company through Foreign Direct Investment (FDI) of Rs. 1,000 Mn during FY20 and accretion of profits, tangible net worth turned positive in FY20 with comfortable capital structure. Also, with decline in total debt at the end of FY20, capital structure of the company improved significantly. Debt:Equity and overall gearing ratio of the company was negative at the end of FY19, which improved to 0.79x and 0.89x respectively at the end of FY20. WCL has healthy interest coverage ratio of 13.45x in FY20 (FY19:7.20x) due to high PBILDT earned by the company. Also Total Debt to Gross Cash Accruals (GCA) ratio remains low which improved to 0.61x in FY20 from 1.73x in FY19.

Long track record of operations and strong brand presence in ISP service

WCL is operating since last 25 years in Nepal and is the leading ISP company operating in the country. The company occupied around 34% market share of internet service industry of Nepal with 393,565 active subscriber base as on mid-July 2020. It carries 43% of the country's Internet bandwidth and has widespread coverage covering 73 districts and has 10,000 enterprise circuits connected to offices and organizations. The company has 88 branches across Nepal.

Experienced board & management team

WCL has five experienced directors on its board and is led by Mr. Dileep Agrawal, who is the Chairman and Managing Director of the company. Mr. Agrawal completed his graduation in 1996 from Bates College, Maine, United States and is the promoter of the company who conceptualized WCL. He is responsible for overall corporate management and development of the company. Mr. Manoj Kumar Agrawal and Mr. Bijay Kumar Jalan are the Executive Directors of the company and are associated with WCL since inception. Mr.

Arun S Korati is a representative Director on the Board from CDC Group. Dr. Bindu Nath Lohani is an Independent Director in the company and holds a Doctorate degree in Engineering. He is also a member of the National Academy of Engineering of United States. The Directors of the Company are supported by a team of experienced professionals. Mr. Sanjay Kumar Sah (Group Chief Financial Officer & Company/Board Secretary), Mr. Keshav Nepal (Chief Executive Officer) and Mr. Samit Jana Thing (Chief Technical Officer) are the Key Managerial Personnel of the Company. Mr. Sah holds Chartered Accountancy degree from ICAI, India and is with the company for more than four years. Mr. Sah has an overall experience of more than 14 years in financial management and controllership, financial planning & analysis and strategic financial decisions.

Investment from strong institutional shareholder

CDC Group plc (CDC) is UK's development finance institution, wholly owned by the UK Government. In 2019, CDC invested approximately \$12 million (~ NPR. 1, 350 Mn) out of which NPR 1,000 Mn was directly invested in WCL which is CDC's first equity investment in Nepal by acquiring a stake of 10% in the company through its investment arm CDC Nepal Opportunities Limited. The amount received from CDC has been utilized in building up the network infrastructure of the company. CDC has investments in over 1,200 businesses in emerging economies with total net assets of £6.5bn.

Steady increase in subscriber base, however with decline in ARPU in FY20

WCL's active subscriber base has grown by 41.14% in FY19 and by 23.24% in FY20. However, Average Revenue Per Unit (ARPU) of the company has slightly declined to Rs. 1,210 per user in FY20 from Rs. 1,218 per user in FY19 due to various promotional packages and discounts offered to add subscriber base in newly developed coverage areas. However, with reduction in these promotional packages, ARPU has been gradually improving in FY21 with ARPU of Rs. 1,249 per user in 4 months period of FY21. While declining ARPU levels have had an impact on the company's operating profitability, the same has been supported by cost advantage arising from economies of scale thus, resulting in marginal increase in PBILDT margins in FY20. WCL's wide customer base offers fair degree of revenue visibility to the company.

Wide portfolio of services offering revenue visibility

WCL offers a wide array of services where revenue from ISP services is a major component of the total income. Backed by diversified service offering, the company has been able to create a broad customer base across business segments. WCL also provides Internet Protocol Television (IPTV) services to its customers and has a subscriber base of 22,7000 customers as on mid- January 2021 which has increased from 174,741 subscriber as on mid-July 2020. WCL has managed to maintain its market share in Nepal and also increase its subscription revenues in the past. The ability of company to retain the acquired customers, thereby reducing churn through competitive pricing and content offering while maintaining its profitability would be key to its future prospects.

Market leader as internet service provider

As per the report published by Nepal Telecommunications Authority, total internet subscriber base of Nepal was 11,71,333 at the end of FY20. Out of which WCL occupies 33.60% in FY20 (PY 37.10%) with subscriber base of 393,565 as on same date. WCL is the market leader in internet subscriber base of Nepal in fiber segment, holding more than 43% of market share during FY20. Though the market share of WCL is decreasing during last 1 year, the subscriber base of the company has been increasing continuously with being market leader in fiber and overall fixed broadband segment. Currently, WCL is connected in 4,08,500 households, 10,030 Public Locations with over 2.1 million users. The company has recorded 1.2 Tbps Network Traffic Utilization and has 1,51,000 daily Public users. WorldLink houses 3950 employees and has 2720 enterprise customers as well.

Increased efforts for market penetration

World Link is a leading player in urban Nepal and as the country's largest ISP it is now also venturing into rural Nepal to provide reliable and affordable internet services. As part of its market penetration plans, WorldLink has channeled a part of the investment received from CDC towards furthering its reach in rural areas. The company is also structuring and decentralizing in an attempt to reach out to remote parts of the country. Also in order to increase internet penetration, it has been promoting and introducing affordable pricing plans in villages and other rural centers. The company has been able to reach to remote areas of Nepal such as Chhatrakot and Ruru rural municipalities in Gulmi districts and several remotest part in Karnali regions.

Latest technology and resources to increase outreach

Worldlink is the pioneer in fiber connectivity in Nepal and is the first private company in the country to connect through satellite. It is also the first company to have its own wireless trunk network. WorldLink introduced FTTH (Fiber to the Home) technology in 2012, after years of research. In 2018, the company announced a partnership with the Finnish multinational IT infrastructure firm Nokia to expand its FTTH network to reach out to one million Nepali households. Till date, the length of its fiber network across the country totals 8,000 kms. Worldlink's updated technology makes it capable of competing globally because of the same technological parity.

Key Rating Weaknesses***High capital and technology intensive nature of industry***

It is an inherent nature of telecom industry which requires high capital investments and long gestation period necessitating substantial funding support. Currently, WCL's fiber network is mostly concentrated to major cities with dense population. In order to increase its footprint WCL is planning to roll out additional fiber coverage on their network. Rolling out fiber network in remote areas of Nepal is a capital intensive business. The ability of the company to withstand the increasingly competitive business environment in internet business and maintain low leverage profile despite higher capex plans remains the key rating

sensitivity. Any debt funded capital expenditure/acquisition impacting the overall financial risk profile will impact the rating of the company. Going forward the company is likely to continue its capital expenditure to ramp up its ISP business, however, the same is expected to be supported by high operating cash flows which are likely to improve primarily due to higher customer base and stable ARPUs with dominant market share which would translate in adequate debt coverage indicators.

Increasing competition in the industry with fragmented market

With increasing digitization, number of ISP's in the country has increased significantly. As on mid-July 2020, there were 40 licensed ISP's operating in Nepal with total internet subscriber base of 11,71,333. The competitors for WCL's internet and related network services include not only other internet service providers, but also existing telecommunications companies planning to foray in this segment. Predatory pricing of any new entrant in this segment may adversely impact WCL's market share and APRU levels. Further, currently the market is fragmented which has resulted into duplicating and in order to meet customer expectation of internet availability in low pricing, the prices have come down thereby affecting the margins. Accordingly, WCL's market share has been declining from 37% in FY19 to 34% in FY20, however in absolute terms subscriber base has been increasing.

Government policy towards Internet Service Providers

The cost of infrastructure provided by the government to ISP's is on increasing trend. Effective from mid-July 2019, the Nepal government levied Telecommunication Service Charge (TSC) of 13% on internet subscription in addition to the existing 13 percent Value Added Tax (VAT). The newly levied service charge was adjusted in the cost of the ISP's without increasing the consumer prices. Further, in August 2019, Nepal Electricity Authority (NEA) has sought to hike the fee for its infrastructure being used by the ISPs, which is likely to take upward the cost of internet use. WCL along with other ISPAN (Internet Service Providers of Nepal) members have not accepted the proposed rate and hence due to this disagreement, NEA has not raised any invoice in the previous and current financial year. Government of Nepal has set up a High Power Committee in order to resolve the issue. Also, company has been booking expenses on the basis of previously raised invoices by NEA and in the event if the decision is in favour of NEA the impact on the financial profile of the company is expected to be minimal.

Exposed to foreign exchange fluctuation risk with net foreign exchange losses during FY20

The Customer Premises Equipment's (CPEs) installed at the subscribers' premise are majorly imported from China and payment is done in foreign currency. The procurement of CPEs which is positively correlated with the growth in subscriber base leads to large outflow of forex. WCL has no earnings in foreign currency, however the company manages its foreign currency risk by not holding the payables in foreign currency for longer duration. However, the company currently partially hedges its foreign currency exposures by executing forward contracts to minimize risk of foreign exchange fluctuations. During FY20, WCL booked net foreign exchange loss of Rs. 58.82 Mn as against gain of Rs. 8.08 Mn in FY19.

Exposure to technology risk associated with internet business

Technology related companies are in particular prone to obsolescence risk and their revenues can be significantly affected with technology risk wherein the end users migrate from obsolete technologies to most recent technology. Therefore, this risk remains a concern for the company, if company is not able to timely upgrade itself to latest technologies. New technology may have short lifecycle considering the continued spend on Research & Development and faster adoption of new technologies. Any change in technology may impact the operations of the broadband industry. However, WCL has been continuously involved in research and development activities to on-board new technologies in Nepal.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. The company has to invest huge amount in customer premises equipment (CPE) and other accessories. Generally WCL import CPEs by opening letter of credit (LC), however full recovery of the same from the customers happen on due course of time which results into high reliance on working capital loans. During FY20, WCL had inventory turnover of 90 days and debtors turnover of 15 days with creditor turnover of 73 days. Due to high creditor days, operating cycle of the company was low at 33 days in FY20. However, the working capital limits utilization from Banks was on lower side due to prepayment nature of operations and huge cash generating business giving sufficient liquidity cover. The average month end working capital utilization of the company for last 12 months ending mid-January 2021 was at 13%.

About the Company

Worldlink Communications Limited (WCL) was incorporated on January 21, 1996 as a private limited company and later converted to public limited company on April 24, 2019. WCL is Nepal's largest Internet Service Provider and third-largest telecom company in Nepal with 25 years in the industry under the brand name of 'Worldlink'.

Brief Financial Performance during the last 3 years is as follows:

(Rs. In Million)

| For the year ended Mid July | FY18 | FY19 | FY20 |
|--|----------------|----------------|----------------|
| | <i>Audited</i> | <i>Audited</i> | <i>Audited</i> |
| Income from Operations | 4,124 | 5,041 | 6,545 |
| PBILDT Margin (%) | 33.35 | 34.96 | 35.14 |
| Overall Gearing (times) | (7.40) | (9.49) | 0.89 |
| Interest coverage (times) | 7.75 | 7.20 | 13.45 |
| Current Ratio (times) | 0.83 | 0.94 | 1.35 |
| Total Debt/Gross Cash Accruals (times) | 2.00 | 1.73 | 0.61 |

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Annexure 1: Details of the Facilities Rated

| Nature of the Facility | Type of the Facility | Amount (Rs. Million) | Rating |
|--|-----------------------------|---------------------------------|--------------------|
| Long Term Bank Facilities | Term Loan | 787.18 | CARE- NP A |
| Short Term Bank Facilities | Working Capital Limits | 140.00 | CARE-NP A2+ |
| Short Term Bank Facilities | Non-Fund Based Limits | 920.00 | CARE-NP A2+ |
| Short Term Bank Facilities (Proposed) | Non-Fund Based Limits | 352.82 | |
| Total | | 2,200.00 | |