Subisu Cablenet Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	**1,587.94 (Decreased from 1,742.59)**	**CARE-NP BB+ [Double B Plus]**	**Reaffirmed**
Short Term Bank Facilities	**2,040.42 (Increased from 1,885.77)**	**CARE-NP A4+ [A Four Plus]**	**Reaffirmed**
Total Facilities	**3,628.36 (Three Billion Six Hundred Twenty-Eight Million and Three Hundred Sixty Thousand Only)**		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed ratings of 'CARE-NP BB+' assigned to the long-term bank facilities and 'CARE-NP-A4+'assigned to the short-term bank facilities of Subisu Cablenet Limited (SCL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SCL continue to be constrained by its highly leveraged capital structure, albeit with moderate debt service coverage indicators and elongated operating cycle marked by high inventory period leading to higher reliance on borrowings. The ratings also factor in SCL's presence in an increasingly competitive industry with fragmented market, high capital and technology intensive nature of industry, exposure to foreign exchange fluctuation risk and exposure to technology risk associated with internet service industry and government policy towards Internet Service Providers (ISPs).

The ratings, however, derive strength from SCL's long established track record of operations with widespread reach, reasonable market share in internet services industry and experienced promoters and management team in the related field. The ratings also factor in the SCL's satisfactory financial performance over FY21-FY23 (FY refers to the twelve-month period ending mid-July) with improving cash accruals from operations. The ratings are further supported by SCL's diversified customer base with healthy revenue mix from retail and corporate segments and SCL'S market presence over the period.

Going forward, the ability of the company to maintain the growth in revenue, while improving profitability and efficient working capital management leading to lower dependence on borrowings will remain the key rating sensitivities. Also, the ability of the company to withstand the increasingly competitive business environment in internet business and maintain market share as well as any substantial debt funded capital expenditure impacting the overall financial risk profile of the company also remains the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly leveraged capital structure

SCL continues to have leveraged capital structure marked by overall gearing of 4.59x at the end of FY23, slightly improved from 4.88x at the end of FY22. The debt levels are high pertaining to recent capital expenditures and funds used for working capital needs. Moreover, the company's net worth base remains relatively smaller as accretion of profits to net worth remains low amid high depreciation leading to low net profits. Owing to higher debt levels, SCL has a substantial interest outgo. However, debt protection metrics continue to remain relatively controlled with total debt to Gross Cash

[1] *Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications*

Accruals (GCA) of 5.34x during FY23, improving from 5.83x in FY22 owing to sustained cash accruals from operations. Similarly, SCL's interest coverage stood moderate at 2.39x during FY23, declining slightly from 2.47x during FY22 amid higher interest rates. Overall, the company's credit metrics remain heavily indebted and may remain in higher range due to its potential need for regular investment in its internet business. A reduction in reliance on external credit leading to improvement in the overall capital structure will remain critical from analytical perspective.

Elongated operating cycle marked by high inventory period

The operations of the company are working capital intensive in nature as it has to invest huge amounts on network devices and customer premises equipment and other accessories. The company's operating cycle was elongated at around 142 days in FY23 (FY22: 137 days) mainly due to higher inventory holding related to then ongoing projects (albeit absolute amount decreased to Rs. 695 Mn from Rs. 1,114 Mn after completion of a major project during FY23). Nevertheless, SCL had average inventory turnover of 130 days in FY23. Furthermore, the company's average collection period was around 85 days in FY23 majorly due to receivables pending from the government projects. This had led to high reliance of the company on the bank finance for working capital needs. As per bankers, the average utilization of the fund- based working capital limits against sanctioned limit was more than 80%-90% for the last 12 month.

High capital and technology intensive nature of industry

It is an inherent nature of telecommunication industry to require high capital investments and long gestation period necessitating substantial funding support. Building a fiber network in a new area requires huge capital. A fixed broadband network's rollout is a drawn-out process that calls for large financial outlays over time. Before reaching scale, a large capital expense might be required. Furthermore, given the difficulties in gaining access to customers' homes, building a door-to-door last mile network is challenging, time-consuming, and expensive. The ability of the company to withstand the increasingly competitive business environment in internet business and to improve its leverage profile despite any substantial future Capex remains the key rating sensitivity. To remain competitive in the ISP business, substantial capital expenditures are likely in the future as well. Although some of this requirement is expected to be partly supported by operating cash flows, any major project related Capex would require outside debt. Sustained high debt levels could translate in moderate debt coverage indicators, particularly amid pressure on profitability owing to declining average revenue from customers.

Exposed to foreign exchange fluctuation risk with net foreign exchange losses during FY23

SCL imports various equipments from other countries for its operations and has payables in foreign currency. Furthermore, bandwidth expenses to some vendors are also done in USD. However, SCL has no earnings in foreign currency. Hence, the company is exposed to foreign exchange fluctuation risk. The company currently does not hedge its foreign exposure. The company incurred Rs. 17 Mn exchange loss in FY23 (FY22: Rs. 38 Mn loss).

Increasing competition in the industry with fragmented market

With increasing digitization and surging demand for internet services, number of ISPs has been increasing significantly in the country. As on mid-October 2023, there were 62 licensed ISPs operating in Nepal with total internet subscriber base of around 2.91 million. The competitors for SCL'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 also adversely impact SCL's market share and ARPU levels thereby affecting its profitability margins. In addition, currently the market is fragmented which has resulted into duplicating and in order to meet customers' expectation of internet availability in low pricing, the prices have come down, thereby affecting the margins.

Exposure to volatile interest rates risk

Sustained requirement for short-term working capital borrowings has led to relatively high interest outgo for SCL (Rs. 389 Mn during FY23), impacting its net profitability. The company's interest rates are based on floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system, which leads to changes in interest rates. Amid tight liquidity interest rates have been on the higher side over FY22 and FY23. Consequently, interest burden of the company is likely to have remained higher in FY24 as well, squeezing its profitability and impacting its liquidity position.

Key Rating Strengths

Long track record of operations, widespread reach and increasing market share in internet service industry

Incorporated on August 16, 1999, SCL has been operational in Nepal for over 20 years. SCL started its operations as a cable TV and cable internet provider and is currently among top 5 ISP in the country in terms of overall subscriber base. SCL had around ~10% market share in the internet service industry in Nepal with around 0.28 Mn active subscriber-base as on mid-January 2024. Furthermore, SCL has a widespread coverage in the country with presence in all 77 districts of Nepal. It has 10 stations inside Kathmandu valley and around 31 branches spread around the country. Furthermore, its network also includes 157 franchises and other businesses.

Experienced promoters & management team

SCL has six experienced promoters who also make up its board of directors. SCL's board is led by Mr. Surendra Shrestha, Chairman, who has experience in financial management for more than two decades and has been a part of the company since its inception. Four of the Five members in the board have an engineering background with technical expertise in the information technology sector. The board is aptly supported by an experienced management team led by Mr. Binay Mohan Saud, Chief Executive Officer, who has over two decades of experience in the telecommunications industry. Having a highly experienced promoter group and management team who are also well acquainted in the technical knowhow of the sector augurs well for the business prospects of SCL in the booming yet increasingly competitive internet service industry of Nepal.

Satisfactory financial performance over FY21-FY23 with improving cash accruals

SCL's revenues had increased at annual growth rate of around 7% over FY21-FY22, boosted majorly by an increasing subscriber base for internet in the country. However, in FY23, SCL's total operating income decreased by 8.13% year-on-year (y-o-y) over FY22 to Rs. 3,464 Mn, majorly on account of moderation in revenues from the retail segment coupled with lesser income from projects. However, PBILDT margins improved to 26.83% in FY23 from 23.05% in FY22 supported by lower cost of sales and also on account of moderation in the company's administrative costs. SCL's ARPU remained on a declining trend from historical averages mainly due to increasingly competitive rates, promotional packages and discounts offered to add subscriber base, particularly in newer coverage areas. SCL reported PAT of Rs. 16 Mn in FY23 compared to Rs.15 Mn in FY22. PAT margin remains below 1x. However, gross cash accruals remained healthy at Rs. 530 Mn in FY23, up from Rs. 496 Mn in FY22. Going forward, owing to the highly competitive nature of the industry, ARPU levels are likely to remain checked and consequently impact the company's operating profitability.

Diversified revenue base in terms of clientele and service

The company reported 52% of its sales in FY23 from retail customers (FY22: 52%) which further improved to ~60% in H1FY24, 24% from corporate clients (23%) and 17% (18%) from various projects. Growth in revenues from retail customers was lower in FY23 amid muted ARPU levels. However, this has improved somewhat in H1FY24 aided by increased subscriber base. Furthermore, TV services contributed 7% to the company's revenues in FY23 and which has remained in the similar levels in H1FY24. Backed by diversified service offering, the company has been able to create a broad customer base across business segments. SCL's ability to obtain tenders for various government projects, steady corporate clientele and increasing retail subscriber base has resulted in a diversified customer base that has helped SCL reduce customer concentration risk.

About the Company

SCL was incorporated on August 09, 1999 as a private limited company and later converted to public limited company on March 05, 2022. SCL was the first cable internet service provider in Nepal and the company currently provides high speed fiber and cable internet as well as digital TV services among others. SCL is the among top 5 ISP in Nepal, in terms of retail subscriber base and has been operational in the industry for around 20 years.

Financial Performance

(*Rs. Million)*

For the Period Ended Mid-July,	FY21	FY22	FY23
	(12m, A)	(12m, A)	(12m, A)
Income from Operations	3,512	3,771	3,464
PBILDT Margin (%)	22.35	23.05	26.83
Overall Gearing (times)*	6.19	4.88	4.59
Interest Coverage (times)	2.36	2.47	2.39
Total Debt/ Gross Cash Accruals (times)	7.79	5.83	5.34

A: Audited

**Tangible net worth for the calculation of overall gearing is exclusive of revaluation reserve.*

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	**Term Loan**	**1,587.94**	**CARE-NP BB+ [Double B plus]**
Short Term Bank Facilities	**Fund Based Limits**	**464.40**	**CARE-NP A4+ [A Four plus]**
Short Term Bank Facilities	**Proposed loan**	**261.02**	**CARE-NP A4+ [A Four plus]**
Short Term Bank Facilities	**Non-Fund Based Limits**	**1,315.00**	**CARE-NP A4+ [A Four plus]**
Total		**3,628.36**	

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About CARE Ratings Nepal Limited:

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