Subisu Cablenet Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	**2,163.46**	**CARE-NP BB+ [Double B plus]**	**Assigned**
Short Term Bank Facilities	**1,464.90**	**CARE-NP A4+ [A Four plus]**	**Assigned**
Total Facilities	**3,628.36**		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB+' to the long-term bank facilities and 'CARE-NP-A4+' 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 are constrained by its leveraged capital structure with modest debt service coverage indicators and working capital intensive nature of operations 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. The ratings also factor in the steady improvement in SCL's financial performance marked by sustained growth in revenues and steady profitability backed by sustained increase in subscriber base over FY19-FY21 (FY refers to the twelve-month period ended mid-July). The ratings are further supported by SCL's diversified customer base and increasing market penetration and 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 with modest debt service coverage indicators

SCL's capital structure is highly leveraged with overall gearing ratio of 6.17x and total debt/gross cash accrual at 8.24x at the end of FY21 owing to the high debt levels pertaining to the recently incurred capital expenditures as well as funds utilized for working capital needs. Total debt stood at Rs. 3,392 Mn at the end of FY21 (FY20: Rs. 2,772 Mn). Debt to Equity ratio of the company was also high at 3.63x at the end of FY21, which had improved marginally from 3.93x at the end of FY20. Owing to higher debt levels, SCL has a substantial interest outgo. SCL's interest coverage stood at 2.38x during FY21, improving slightly from 1.98x during FY20. Overall, the company's credit metrics remain highly leveraged and could remain on the higher side given the possible need for recurring investments in the internet business. Lesser dependence on outside borrowings leading to improvement in the overall capital structure of the company will remain crucial for improving its overall financial risk profile.

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

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as it has to invest huge amounts on network devices and customer premises equipments and other accessories. The company's operating cycle was elongated at around 143 days in FY21 mainly due to higher inventory holding related to ongoing projects. SCL had inventory turnover of 146 days at the end of FY21. Furthermore, the company's average collection period was around 86 days at the end of FY21 majorly due to receivables pending from the government projects. However, majority of these projects are likely to be completed by FY22 and going forward, the working capital requirements of the company are expected to be lower than the historical levels. Shortening of operating cycle leading to lower levels of working capital borrowings would also remain a key monitorable.

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. The company has majorly depended on outside borrowings for its capital expenditures incurred over FY19-FY21. This has led to increased long-term debt which stood at around Rs.1,996 Mn as on mid-July 2021. Including a couple of "Pradesh" (Province) level network expansion projects, the company has incurred significant capital expenditures over FY19-FY21 with total cash outflow of around Rs. 3,132 Mn during the period. Going forward, the company is likely to moderate its capital expenditure, however, 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 capex would require substantial outside debt, translating to moderation of debt coverage indicators.

Exposed to foreign exchange fluctuation risk with net foreign exchange losses during FY21

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. 5.2 Mn foreign exchange loss in FY21 (FY20: Rs. 8.5 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-December 2021, there were 53 licensed ISPs operating in Nepal with total internet subscriber base of around 1.88 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 APRU levels thereby affecting its profitability margins.

Interest rate risk

The company's interest expense is based on floating rates which reset every quarter. The base rate of the banks and financial institutions in Nepal remains quite volatile as they are impacted by change in liquidity position which leads to change in interest rates. Therefore, funding taken by the company from banks is subject to volatile interest rate.

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 the third largest ISP in the country in terms of overall subscriber base. SCL had around 13% market share in the internet service industry in Nepal with around 0.25 Mn active subscriber-base as on mid-December 2021. SCL has second largest market share in the fiber internet segment in the country. 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 30 branches spread around the country. Furthermore, its network also includes 193 service franchises as on mid-October 2021.

Experienced promoters & management team

SCL has seven 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 20 years and has been a part of the company since its inception. 4 of the 5 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 20 years 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.

Steady improvement in financial performance marked by sustained revenue growth and steady profitability

SCL's revenues have increased at a compounded annual growth rate (CAGR) of around 14% over FY18-FY21, boosted majorly by an increasing subscriber base. The company's total income during FY21 was Rs. 3,513 million, up 21% year on year amid surge in demand for internet in the country backed by government's focus in increasing digitization coupled with the covid19 pandemic which has led to more people working/studying from home. SCL's PBILDT margin have remained steady around 20%-22% over FY19-FY21, with impact of the increasing scale of operations somewhat offset by moderation in average revenues per unit (ARPU) amid intense competition. Going forward, owing to the highly competitive nature of the industry, APRU levels are likely to remain checked and consequently company's operating profitability is likely to remain steady despite expected sustained revenue growth over the medium term. Particularly, in the more competitive retail internet business, the ability of the company to retain acquired customers, thereby reducing churn through competitive pricing and content offering while maintaining its profitability would be key to its future prospects.

Diversified revenue base in terms of clientele and service

SCL offers a wide array of services to a well-diversified client base. The company reported 58% of its revenues in FY21 from retail customers (FY20: 53%), 24% from corporate clients (27%) and 18% (20%) from various projects. Although retail internet income constitutes the major component of total income, the company also books sizeable revenues from enterprise internet and intranet, television subscription, and projects (mostly tender based government projects). 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 third largest 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,	FY20 (12m, A)	FY21 (12m, A)
Income from Operations	2,901	3,512
PBILDT Margin (%)	23.54	22.50
Overall Gearing (times)	5.93	6.17
Interest Coverage (times)	1.98	2.38
Total Debt/ Gross Cash Accruals (times)	9.38	8.24

A: Audited

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**	**2,163.46**	**CARE-NP BB+ [Double B plus]**
Short Term Bank Facilities	**Fund Based Limits**	**1,314.90**	**CARE-NP A4+ [A Four plus]**
Short Term Bank Facilities	**Non-Fund Based Limits**	**150.00**	**CARE-NP A4+ [A Four plus]**
Total		**3,628.36**	

Contact Us

Analyst Contact
Mr. Santosh Pudasaini
+977-01-4012629
santosh.pudasaini@careratingsnepal.com

Ms. Shalini Sanghai
+977-01-4012629
shalini.sanghai@careratingsnepal.com

Relationship Contact
Mr. Achin Nirwani
+977-9818832909
achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).