Worldlink Communications Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	2,181.53 (Increased from 787.18)	CARE-NP A [Single A]	Reaffirmed
Short Term Bank Facilities	3,010.00 (Increased from 1,412.82)	CARE-NP A2+ [A Two Plus]	Reaffirmed
Total	**5,191.53**		

Annexure-1 Details of Facilities/Instruments to be rated

CARE Ratings Nepal Limited (CRNL) has reaffirmed the ratings of "CARE-NP A" assigned to the long term bank facilities and "CARE-NP A2+" assigned to short term bank facilities of Wordlink Communications Limited (WCL).

Detailed Rationale & Key Rating Drivers

The reaffirmation in ratings assigned to WCL continues to derive strength from its strong financial risk profile at the end of FY21 (audited, refers to the twelve-month period ended mid-July 2021) characterized by growth in revenue, improvement in profitability and comfortable capital structure and debt coverage indicators. The ratings also factor in WCL long track record of operations and strong brand presence in Internet Service Provider (ISP) industry being the market leader supported by a steady growth in its subscriber base, experienced board and 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 the ISP industry and the ongoing majorly debt-funded capex of the company, which could lead to some moderation in the capital structure over the near-term (albeit offset by plans for substantial equity infusion in FY23). The ratings also factor in increasing competition in the industry with fragmented market, working capital intensive nature of operations, exposure to foreign exchange fluctuation risk, susceptibility to regulatory changes and technological risk associated with the ISP business. The rating also takes cognizance of moderation in profitability profile and debt coverage indicators in 9MFY22 (Unaudited, refers to the nine month-period ended mid-April 2022), impacted mainly by increased operational expenses related to the ongoing network expansion.

Going forward, the ability of the company to maintain the growth in revenue with sustained profitability while maintaining capital structure 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 will also remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experienced board and management team

WCL has five experienced directors on its board led by Mr. Dileep Agrawal, 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, Executive Directors, is associated with WCL since inception. Ms. Vaishnavi Suryanarayanan is a representative Director on the Board from CDC Group. The Directors of the Company are aptly 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

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Mr. Samit Jana Thing (Chief Technical Officer) are the Key Managerial Personnel of the Company, with substantial experience in the related field.

Support from strong institutional shareholder

In 2019, British International Investment, formerly known as CDC Group plc (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. CDC is UK's development finance institution, wholly owned by the UK Government. 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 £6.8bn. Further, investments are expected from CDC in WCL in the coming years. Equity infusion by the institutional shareholder is likely to help the company improve its capital structure, which could see some moderation in FY22 amid the ongoing debt-funded capex. Timely equity infusion as envisaged will remain critical from credit perspective.

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

WCL has been operational in Nepal for over 26 years and is currently the leading ISP company operating in the country. The company occupies over 30% market share in the retail ISP segment in the country with active subscriber base of around 6.25 lakhs as on mid-May, 2022. WCL carries over 40% of the country's Internet bandwidth and has widespread coverage covering 70 plus districts and has 10,000 plus enterprise circuits connected to offices and organizations. The company has 140 branches across Nepal. Furthermore, WorldLink has established network infrastructure into 140 new locations in FY22 and plans to establish in additional 120 locations in in the coming years.

Sustained leadership position in market backed by steady growth in subscriber base, albeit with decline in ARPU

WCL has grown to be Nepal's largest Internet Service Provider. As per the report published by Nepal Telecommunications Authority, total internet subscriber base of Nepal was 1,659,306 at the end of FY21, out of which WCL occupies 31% market share with subscriber base of 510,742 subscribes. WCL is the market leader in internet subscriber base of Nepal in fiber segment, with ~36% of market share during FY21. However, Average Revenue per Unit (ARPU) of the company has declined to Rs. 1,206 per user in FY21 from Rs. 1,210 per user in FY20 due to various promotional packages and discounts offered to add subscriber base owing to the increased competition in the industry. Going forward, APRU levels are likely to remain muted which might have a bearing of on the company's profitability over the near-term, however this is expected to be offset by cost advantage arising from economies of scale over the medium term.

Strong financial risk profile at the end of FY21 characterized by regular growth in revenue and profitability; albeit moderation in 9MFY22 owing to increased capex and lower ARPUs

Total operating revenue of WCL grew 21.53% to Rs. 7,954 Mn in FY21 from Rs. 6,545 Mn in FY20 backed by growing subscriber base, which grew 29.91% to 510,712 amid increasing market penetration and surge in demand for internet in the industry. Similarly, PBILDT margin also improved by 200 bps to 37.14% in FY21 supported by cost advantages arising from economies of scale, although somewhat offset by moderation in average revenues per unit (ARPU) amid intense competition. Consequently, PAT increased by 61.09% to Rs. 917 Mn with PAT margin of 11.52% from 8.69% in FY20.

Revenue growth trend has continued into FY22 with the company reporting revenues of Rs. 6,724 Mn during 9MFY22, however, with some moderation in profitability on account of increased operational expenses, mainly related to around 140 new locations being added during the year, coupled with lower ARPUs. Margins are expected to improve going forward backed by increased revenues from subscribers added in these new locations, although ARPUs are likely see downward pressure amid increasing competition in the near-term. The company's ability to continue the revenue thrust while maintaining a healthy profitability margins would remain critical for its financial profile.

Comfortable capital structure and debt coverage indicators

Debt to Equity ratio of the company improved to 0.17x at the end of FY21 from 0.41x at FY20 end and overall gearing ratio of the company improved to 0.46x at the end of FY21 from 0.89x at FY20 end aided by improved net worth base with accretion of profits to reserve and scheduled repayment of term loans. WCL had healthy interest coverage ratio of 36.69x in FY21 (FY20:13.45x) due to high operating profits earned by the company and reduced interest expenses amid lower interest rates. Similarly, total debt to GCA ratio stood comfortable at below unity in the last 2 financials years (FY20 & FY21). Although overall capital structure and debt coverage indicators of the company are likely to moderate somewhat over the near-term amid requirement of increased debt to fund ongoing network infrastructure set up in various new locations, the company is expected to maintain sufficient gearing headroom, assisted also by planned equity infusions of around Rs. 2,000 Mn during FY23. The expected infusion is a key monitorable and crucial for company to maintain its financial risk profile at satisfactory levels coupled with to fund its expansion plans.

Diversified portfolio of services offering revenue visibility

WCL offers a wide array of services to a well-diversified client base and revenue ISP services is a major component of the total income. The company reported 41% of its revenues in FY21 from retail customers in ISP Service, 7% from corporate customer in ISP Service. Although ISP constitutes the major component of total income, the company also books sizeable revenues from monitoring and technical support, data connectivity and other sales. WCL has managed to maintain its dominant market share in Nepal and also increase its subscription revenues. 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.

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 13,646 kms. Worldlink's updated technology makes it capable of competing globally because of the same technological parity.

Key Rating Weakness

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. Similarly, to order to increase the outreach in uncovered area, the company has established network infrastructure in 140 new locations in FY22 for which significant capital expenditures has been incurred, which were funded through additional debt and internal accruals. The company plans to establish network infrastructure in 120 new locations in FY23, which is expected to be partly supported by operating cash flows, additional equity from investors and outside debts with expected capex of around Rs. 4,000 Mn. To remain competitive in the ISP business, substantial capital expenditures is a necessity, however substantial outside debt could translate to moderation of debt coverage indicators. This will remain a key monitorable aspect.

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 2021, there were 44 licensed ISPs operating in Nepal with total internet subscriber base of 1,658,306 which has since increased to 58 ISPs with subscriber base of 2,137,961 as on mid-May, 2021. The competitors for WCL's internet and related network services include not only other internet service providers, but also existing telecommunications companies planning to increase their presence in the 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 and further to 31% in FY21 and 9MFY22, however in absolute terms subscriber base has been increasing.

Working capital intensive nature of operations and exposure to foreign exchange fluctuation risk

The operations of the company are working capital intensive in nature. The company has to invest huge amounts on customer premises equipment (CPE) and other accessories. Generally, WCL imports CPEs by opening letter of credit (LC) having payable period of upto 4 months; 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 FY21, WCL had inventory turnover of 108 days and debtors turnover of 13 days with creditor turnover of 85 days. Due to high creditor days, operating cycle of the company is low at 36 days in FY21. This all led to working requirement, which was met to bank borrowing.

Furthermore, the CPE 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. The company currently partially hedges its foreign currency exposures by executing forward contracts to minimize risk of foreign exchange fluctuations. During FY21, WCL booked net foreign exchange gain of Rs.9.78 Mn as against the loss of Rs. 58.82 Mn in FY20.

Susceptibility to regulatory changes

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 10% on internet subscription in addition to the existing 13% 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.

Technological risk associated with ISP 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.

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 Financials of the company during last 3 years is as under

(Amount in Rs. Million)

For the year ended mid-July	FY19	FY20	FY21
	Audited	Audited	Audited
Income from Operations	5,041	6,545	7,954
PBILDT Margin	34.96	35.14	37.14
Overall Gearing (times)	-9.49	0.89	0.46
Interest coverage (times)	7.20	13.45	36.69
Current ratio (times)	0.94	1.34	1.20
Total Debt/GCA	1.73	0.61	0.41

Annexure-1 Details of Facilities/Instruments to be rated

Name of Instrument	Type of Facility	Amount(Rs in Million)	Rating
Long Term Bank Facilities	Term Loan	2,181.53	CARE-NP A
Short Term Bank Facilities	Fund Based	140.00	CARE-NP A2+
Short Term Bank Facilities	Non-Fund Based	2,870.00	CARE-NP A2+
Total		**5,191.53**	

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About CARE Ratings:

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