Classic Tech Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	789.90	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	510.08	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,299.98 (One Thousand Two Hundred Ninety Nine Million and Nine Hundred Eighty Thousand Only)		

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 Classic tech Private Limited (CTPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of CTPL are constrained by its leveraged capital structure and moderate scale of operations coupled with revenue concentration risk in the increasingly competitive retail internet business. The ratings also factor in the working capital intensive nature of operations leading to elongated operating cycle, CTPL's presence in a competitive industry with fragmented market, high capital and technology intensive nature of industry, exposure to the volatile interest rate, technological risk associated with internet broadband business and government policy towards Internet Service Providers (ISPs).

The ratings, however, derive strengths from CTPL's long established track record of operations with widespread reach, reasonable market share in the internet service industry and experienced promoter and management team in the related field. The ratings assigned also factors in the steady improvement in CTPL's operational performance aided by sustained increase in subscriber base over FY19-FY22 (FY refers to the twelve-month period ended mid-July) and increasing market penetration and presence over the period, albeit with declining trend in average revenue per customer in the industry.

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 shall remain the key rating sensitivities. Also, the ability of the company to withstand the increasingly competitive business environment in the internet business and to 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

Leveraged capital structure

The capital structure of CTPL stood leveraged (advances from directors not treated as debt) as on mid-July 2022 with debt to equity and overall gearing ratio of 3.35x and 3.60x, respectively, (PY: 2.66x, 2.95x, respectively). Total debt of the company increased by Rs. 100 Mn, majorly long-term loans drawn for funding ongoing capex while accretion to net worth was by only Rs. 9 Mn, leading to the sequential deterioration in the gearing levels in FY22. Debt service coverage indicators, however, were fairly adequate supported by sustained cash generated from operations. Interest coverage ratio was 4.43x and Total Debt/Gross Cash Accruals was 6.87x at the end of FY22 (PY: 4.16x and 6.00x, respectively).

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

Furthermore, Total Outside Liabilities/Net worth of the company stood high at 12.50x at the end of FY22 (PY: 10.24x). Overall, the capital structure of company is leveraged and gearing is likely to remain on the higher side over the near-term accounting for the ongoing/planned partly debt funded capex by the company over medium-term.

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. CTPL's operating cycle was elongated at around 99 days at the end of FY22 mainly due to higher inventory holding. CTPL had inventory turnover of 136 days and average collection period of 47 days during FY22. High inventory holding during FY22, to a major extent, is due to 2G routers being replaced by 5G routers and 2G routers are still in stock in various branches. Rationalization of inventory leading to shortening of operating cycle could free up additional cash and lessen the burden on borrowings for meeting working capital/capex needs of the company

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.

Increasing competition in the industry with fragmented market

With increasing digitization and surging demand for internet services, the number of ISPs has been increasing significantly in the country. As on mid-July 2022, there were 60 licensed ISPs operating in Nepal with total internet subscriber base of around 2.23 million. CTPL's competitors for Internet and related network services include other Internet Service Providers as well as incumbent telecommunications companies looking to enter this segment. Predatory pricing for new entrants to this segment could adversely affect traditional technology's market share and his APRU level. 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.

Interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly 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 change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in the rate hikes taken by BFIs in the first quarter of FY23. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Exposure to technology risk associated with broadband internet business

Companies in the technology sector are particularly vulnerable to obsolescence risk, and end users switching to more modern technology can have a substantial impact on their revenues. If the organization cannot quickly upgrade to the most recent technologies, this risk may continue to be a problem. In order to provide speedier broadband services, fixed broadband providers are investing in new technology. Telecommunications providers are investing in the rollout of fiber optic cable while simultaneously modernizing copper networks from Asymmetric Digital Subscriber Line (ADSL) to Very-high-Bit-Rate Digital Subscriber Line (VDSL). Given the constant investment in R&D and the rapid adoption of new technologies, new technology may have a short lifecycle. Any advancement in technology could have an effect on how the broadband sector functions.

Key Rating Strengths

Experienced promoter and established track record of operations with widespread reach in internet service industry

CTPL launched its services as an Internet Service Provider (ISP) on August 29, 2010 and as a network service provider on March 31, 2014, with an operational track record of more than twelve years as an ISP. CTPL is the fourth largest ISP in Nepal based on total number of subscribers. As on July 16, 2022, CTPL had around 10.30% market share in Nepal's internet service industry with a customer base of 0.23 Mn active subscribers. CTPL has a widespread coverage in the country with its presence in 74 districts of Nepal (out of 77 districts). It has 28 branches inside valley and around 104 branches spread across the country.

CTPL is promoted by Mr. Pramesh Kharel, Chairman/Managing director, having managerial and technical experience of over a decade in the internet service industry. He is supported by an experienced team across various functions.

Steady growth in income with stable profitability, yet concentrated on retail segment.

CTPL's Total Operating Income (TOI) have increased at a compounded annual growth rate (CAGR) of around 17% over (FY18-FY22), boosted majorly by an increasing subscriber base and a growing demand for internet in the country. The company’s total income during FY22 was Rs. 875 Mn, up 5% from FY21. CTPL’s PBILDT margin have steadily improved from 16% to 18% over FY20-FY22, benefitting from increasing scale of operations. Despite an increasing trend, the company’s revenue base is concentrated on the retail internet segment, which contributes around 90% of the company’s TOI. The company is looking to increase its presence in the corporate segment. A more diversified revenue base and clientele could help absorb pricing pressure and maintain margins particularly given the intense competition in the retail segment. In the retail segment, 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

Increasing demand outlook with growing subscriber base and reasonable market share

Internet subscriber base, particularly for fiber internet, has seen substantial growth in Nepal during FY19-FY22, growing over 80% year-on-year during this period. This trend of increased internet usage saw a significant uptick because of the Covid-19 pandemic outbreak in March 2020. The growing need for work from home and online classes amid the corona virus infection fears led to an excessive rise in the number of subscriptions across the country. Internet subscribers in Nepal at the end of FY19 were 0.86 Mn. This has jumped to 2.23 Mn equivalent to a growth rate of 26%. Over FY19 to FY22, most major ISPs have reported substantial increase in their subscriber base. Increasing outreach, comparable service at competitive rates, and relatively sticky customer base leading to a lower customer attrition rate averaging around 8.625% since FY19 has helped CTPL outperform the competition. Consequently, CTPL’s market share has increased from 5.1% at the end of FY19 to 10.3% at the end of FY22.

About the Company

CTPL was incorporated on July 16, 2009 as a private limited company named as a Zero Point Remit Private Limited and later converted to an Internet Service Provider on August 29, 2010 and Network Service Provider on March 31, 2014. CTPL provides dedicated speed internet service to individual houses with Fiber Optical Internet as FTTH Internet service. CTPL is the fourth largest ISP in Nepal in terms of retail subscriber base and has been operational in the industry for around 12 years.

Financial Performance

(Rs. Million)

For the Period Ended Mid-July	FY20(A)	FY21(A)	FY 22 (UA)
Income from Operations	687	837	875
PBILDT Margin (%)	15.88	16.76	17.87
Overall Gearing (times)	3.69	2.95	3.60
Interest Coverage (times)	2.65	4.16	4.43
Total Debt/ Gross Cash Accruals (times)	6.41	6.00	6.87

A: Audited; UA: Unaudited;

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**	**789.90**	**CARE-NP BB [Double B]**
Short Term Bank Facilities	**Fund/Non fund based Limits**	**510.08**	**CARE-NP A4 [A Four]**
Total		**1,299.98**	

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About CARE Ratings Nepal Limited:

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