FitchRatings

Fitch Affirms Sri Lanka's Dialog Axiata at 'AAA(lka)'/Stable

Fitch Ratings - Colombo/Singapore - 23 Feb 2022: Fitch Ratings has affirmed the National Long-Term Rating of Sri Lanka-based telecom company Dialog Axiata PLC at 'AAA(lka)'. The Outlook is Stable.

KEY RATING DRIVERS

Market Leadership: Dialog's Standalone Credit Profile (SCP) of 'aaa(lka)' is driven by its market leadership across mobile, pay-TV and home broadband (HBB) segments. We believe Dialog will continue to gain revenue market share from smaller telcos, given its better execution and mobile network. We do not expect number portability in mobile and fixed-line services, expected to be introduced in 2022, to have a material impact on Dialog's subscriber base as smaller operators cannot provide the same coverage and quality without significant investment.

Support from Strong Parent: Our assessment of a 'Medium' strategic support incentive from its stronger Malaysia-based parent, Axiata Group Berhad (Axiata), results in a one-notch uplift to Dialog's rating, if its SCP were to weaken, according to our Parent and Subsidiary Linkage Rating Criteria. Axiata's strategic incentive to support Dialog is based on the subsidiary's reasonably material financial contribution and the impact of its moderate long-term growth potential on the group's future profile.

We regard the legal support incentive as 'Weak' in the absence of corporate guarantees on Dialog's debt and the lack of cross-default clauses linking the parent's debt to that of Dialog. Similarly, we consider the operational support incentive to be 'Weak' due to minimal operating synergies with the parent despite a degree of common management, with Axiata representation on Dialog's board and senior management.

Strong Revenue Growth: We forecast Dialog's 2022 revenue to rise by about 11%-12% on continued demand for data, and strong subscriber growth in pay-TV and HBB. Revenue rose 18% in 2021, despite a sluggish economy, due to strong subscriber growth across all platforms and improving average revenue per user. Voice and data consumption may weaken if operating conditions worsen amid faster inflation and falling incomes. Dialog may find it hard to pass on a recently introduced 2.5% social security tax or other cost increases without affecting volume.

Stable EBITDA Margins: We expect Dialog's EBITDA margin to remain at 39%-40% (2021: 40%) during 2022-2023, despite the economic pressure. We believe profitability will be supported by robust data-traffic growth, increased 4G adoption and cost-optimisation measures such as digitalisation and automation. Dialog saved LKR5.0 billion in operating costs in 2021, or 3.5% of revenue, through the measures. We expect the stable profitability to help Dialog maintain its solid financial profile with Fitch-forecast 2022 net debt to EBITDA of 0.3x (2021: 0.4x).

Positive FCF, Despite High Capex: We expect Dialog's 2022 cash capex/revenue to be around 25% (2021: 24%, including spillover capex from 2020), spent mainly on 4G capacity, coverage expansion and fibre roll-out to address the increasing demand for data and broadband connectivity. However, we expect Dialog's cash flow from operations to adequately cover the substantial capex planned and its dividend payout, likely to be 50%-60% of net income. We expect this to lead to a free cash flow (FCF) margin of around 2%-3% in the next few years.

However, Dialog's ability to meet its capex plans in a timely manner could be at risk if the country's external finances weaken further, increasing import restrictions. Dialog is able to mitigate this risk with the help of its foreign-currency inflows and deposits and its ability to source its requirements with the support of its parent. The company may also look at foreign-currency lines to fund capex if sourcing foreign currency locally becomes challenging.

Neutral Sector Outlook: We expect the mean 2022 net debt to EBITDA for Dialog and fixed-line market leader Sri Lanka Telcom PLC (SLT, AA-(lka)/Stable) to remain at around 0.8x (2021E: 0.8x). We expect the two to consolidate revenue market share further at the expense of smaller telcos. Telcos are likely to focus on profitable growth and are unlikely to step up price-based competition. We expect 2022 industry revenue growth of 8%-9% (2021E: around 12%-13%) and average 2022 capex/revenue to rise to around 26% (2021E: 24%).

DERIVATION SUMMARY

Dialog's business risk profile is stronger than that of similarly rated national peers, given its market-leadership in Sri Lanka's mobile industry, stable cash generation and integrated service offerings. Dialog's financial profile is better than that of SLT, with lower 2022 forecast net debt to EBITDA of 0.3x than SLT's 1.2x, a larger revenue base and a better operating EBITDA margin. Dialog has demonstrated better market execution than SLT, with its growing market share and rising EBITDA.

Dialog has a comparable business risk profile relative to leading alcoholic-beverage manufacturer Melstacorp PLC (AAA(lka)/Stable). Melstacorp's subsidiary, Distilleries Company of Sri Lanka PLC (AAA(lka)/Stable), controls 70% of Sri Lanka's spirits production, and has maintained its market leadership due to its entrenched brand and access to a countrywide distribution network. However, Dialog has higher ratings headroom as its financial profile is stronger than that of Melstacorp. Dialog's 2022 net debt to EBITDA of 0.3x is lower than Melstacorp's around 2.5x.

Hemas Holdings PLC (AAA(lka)/Stable) is the largest private pharmaceuticals distributor in the country. It is also in the fast-moving consumer goods (FMCG) business. Dialog has a significantly stronger business profile with its market-leading position, larger operating scale and ability to generate a wider operating EBITDA margin, and ability to pass on higher taxes to consumers. Hemas' operations are constrained by regulatory pressures in the form of price controls in its pharmaceutical business and cost escalations in the FMCG sector, which may take time to be passed on to end-customers. We forecast Hemas and Dialog to have similar net leverage ratios of 0.3x-0.4x in the medium term.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue to rise by 8%-10% in 2022-2024

- EBITDA margin to be stable at around 39%-40%

- Capex/revenue of around 25% in 2022-2024

- Effective tax rate of 14%. Dialog to pay a surcharge tax of LKR3.4 billion for 2020, based on the latest budget proposals.

- Dividend to be around 60% of previous year's net income as per the company's policy

- Subsidiary Dialog Finance PLC's debt obligations over and above what is required to maintain an appropriate debt-to-tangible equity ratio of 1.0x will be assumed by Dialog as a hypothetical equity infusion as per Fitch criteria. We assume this to be LKR1.5 billion in 2022, LKR2.7 billion in 2023 and LKR4.0 billion in 2024.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- There is no scope for an upgrade, as Dialog is rated at the highest end on the Sri Lankan National Ratings scale.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- We do not envisage any negative rating action in the medium term due to the standalone strength of the business profile, low financial leverage and implied support from the stronger parent.

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: Dialog had sufficient unrestricted cash of LKR21.3 billion and undrawn but committed bank facilities of around LKR37 billion at end-December 2021, which can cover short-term debt maturities of about LKR31.0 billion. We believe local banks will honour the credit lines extended and roll over the facilities as and when required given Dialog's position as one of Sri Lanka's largest corporates and its solid credit profile. Dialog's debt consisted mainly of a USD90 million syndicated facility and LKR13 billion in term loans at end-December 2021.

ISSUER PROFILE

Dialog is a Sri Lanka-based telecom company with domestic market leadership across mobile, pay-TV and HBB segments.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Dialog Axiata PLC	Natl LT	AAA(lka)	Affirmed	AAA(lka)

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

- National Scale Rating Criteria (pub. 22 Dec 2020)
- Corporate Rating Criteria (pub. 16 Oct 2021) (including rating assumption sensitivity)
- Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 16 Oct 2021)
- Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

Dialog Axiata PLC -

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