

# Dialog Axiata PLC

Dialog Axiata PLC's National Long-Term Rating is driven by its Standalone Credit Profile (SCP) of 'aaa(lka)', which reflects its market leadership across mobile, pay-TV and home-broadband (HBB) segments, better execution and network capability and a solid financial profile, offset to an extent by the high exposure of its revenue to the weak Sri Lankan market.

Fitch Ratings believes that Dialog will be able to maintain a credit profile commensurate with a 'AAA(lka)' rating in the next 12-18 months, despite lower demand for telecom services, escalating costs and a significant increase in the company's debt amid the Sri Lankan rupee's devaluation.

## Key Rating Drivers

**Weak Demand in 2023:** We expect Dialog's revenue growth to slow to around 10% in 2023, from 25% in 2022, amid weakening consumer spending. Consumers are increasingly prioritising essential needs, such as food and medicine, as real income has plunged following the currency depreciation and unprecedentedly high inflation. Dialog faced pressure on subscriber numbers and usage minutes in 2022. Telecom operators raised voice and data tariffs by 20% and pay-TV by 25% in 2022 to pass through the escalating costs, reducing the services' affordability.

We believe the recent increases in telecom taxes would also discourage demand as consumers now have to pay 38% tax on voice and 20% on data. Sri Lanka currently has one of the highest telecom tax structures in Asia. To mitigate its domestic market exposure, Dialog is increasingly focusing on its international businesses and enterprise clients, who are somewhat immune to the local environment. The contribution from the international business climbed to 23% in 2022, from 16%-17% earlier.

**Market Leadership:** Dialog is the domestic market leader across mobile, pay-TV and HBB segments. The competition within the mobile segment has intensified in recent months amid the falling demand, with some of the smaller operators aggressively cutting prices. However, we do not believe such a strategy is sustainable as the smaller telcos do not have the network capability, service quality or the financial strength to compete with operators such as Dialog.

**Low Profitability:** We expect Dialog's EBITDA margin to improve to around 30%-32% over 2023-2024 from 28% in 2022, benefitting from the recent tariff hikes and cost rationalisation measures. Dialog's EBITDA margin contracted by 12 percentage points in 2022 amid the high inflation and currency depreciation. Around 52% of Dialog's direct costs are in foreign currency (FC) compared with only 30% of its revenue, exposing the company to currency volatility.

Dialog expects to streamline its costs by consolidating its facilities, optimising its network and rationalising overheads, but we do not believe this will be sufficient to improve margins to the 39%-40% levels before 2022. The low realisation of the recent tariff hikes amid the drop in usage and increased contribution from the low-margin international business would also mean margins would remain in the low-to-mid 30s range in the next few years.

**High Foreign-Currency Debt:** Around 91% of Dialog's outstanding debt was in FC at end-2022. The depreciation of the rupee by almost 80% in 2022 materially increased Dialog's FC debt exposure, while it had to raise more FC debt to fund capex amid the FC shortage in Sri Lanka. We do not believe Dialog's current FC revenue is sufficient to meet its FC debt obligations, but the company does not have any FC debt repayments due in the next 24 months. Dialog has USD41 million in FC deposits to meet its FC interest costs of around USD12 million per year.

## Ratings

### National Rating

National Long-Term Rating      AAA(lka)

### Outlooks

National Long-Term Rating      Stable

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## Applicable Criteria

[Corporate Rating Criteria \(October 2022\)](#)

[National Scale Rating Criteria \(December 2020\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(December 2021\)](#)

## Related Research

[Spotlight: Rated Sri Lankan Corporates \(October 2022\)](#)

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**Balance-Sheet Restructuring:** Dialog is planning to manage its currency exposure by reducing the FC debt to less than 50% of its outstanding debt by end-2023. It is considering asset monetisation and alternative funding arrangements with existing lenders to achieve a more balanced funding mix. The higher debt stock also raised Dialog's EBITDA net leverage to 1.3x in 2022, from 0.4x in 2021. We expect leverage to remain around 1.0x until there is a sustainable recovery in margins.

**Positive FCF from 2024:** We expect Dialog to generate negative free cash flow (FCF) in 2023 amid low profitability and high capex. Dialog's capex has risen due to the currency devaluation as most of the equipment is imported. Therefore, we expect capex intensity to rise to around 27% of revenue in the next few years from around 23% earlier. Capex will be spent mostly on mobile and fixed-data capacity expansion to cater to the growing demand. Dialog's FCF should turn positive from 2024, once EBITDA margins gradually recover.

**Support from Strong Parent:** Our assessment of 'Medium' legal and strategic support incentive from its stronger parent, Axiata Group Berhad, would result in a potential two-notch uplift to its rating if its SCP were to weaken, according to our *Parent and Subsidiary Linkage Rating Criteria*. Axiata guaranteed around 45% of Dialog's debt as of end-2022. Dialog makes a reasonably material financial contribution to the parent, with moderate long-term growth potential. The operational support incentive is 'Weak' due to minimal operating synergies with the parent.

**Sector Outlook Deteriorating:** Fitch expects the average 2023 net debt/EBITDA ratio for Dialog and fixed-line leader Sri Lanka Telecom PLC (SLT, A(lka)/Stable) to weaken to 1.4x in 2023 (2022E: 1.2x) amid weak margins and high capex. We expect sector revenue growth to slow to 8% in 2023 (2022E: 15%), while the average 2023 EBITDA margin for SLT and Dialog will remain flat at 32% (2021: 38% and 2022E: 32%) amid low usage and high costs.

## Financial Summary

(LKRm)	2020	2021	2022	2023F	2024F	2025F
EBITDA	49,851	57,309	49,885	57,737	68,450	86,468
EBITDA margin (%)	41.6	40.5	28.1	29.9	31.9	36.9
Free cash flow	16,827	12,085	-15,721	-4,018	7,125	7,773
EBITDA net leverage (x)	0.5	0.4	1.3	1.2	0.9	0.7
EBITDA interest coverage (x)	31.1	29.9	20.0	7.9	9.9	14.3

F = Forecast

Source: Fitch Ratings, Fitch Solutions

## Rating Derivation Relative to Peers

Dialog's business risk profile is stronger than that of similarly rated national peers, given its market leadership in Sri Lanka's mobile industry and integrated service offerings. Dialog's financial profile is better than that of SLT, with a larger revenue base, lower forecast EBITDA net leverage and a better FCF profile. However, SLT is the monopoly fixed-line operator in the country and has lower exposure to the crowded mobile market, although its rating is under pressure because of the state's weak credit profile.

Dialog has a better business risk profile than leading alcoholic-beverage manufacturer Melstacorp PLC (AAA(lka)/Stable), reflected in the former's larger operating scale and higher margins. Melstacorp's subsidiary, Distilleries Company of Sri Lanka PLC (DIST: 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, DIST is exposed to high regulatory risk through regular tax increases. We expect both companies to maintain a similar financial risk profile with 2023 net debt to EBITDA of around 1.4x.

Hemas Holdings PLC (AAA(lka)/Stable) is the largest private pharmaceutical 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 the ability to generate a wider operating EBITDA margin and pass on higher taxes to consumers. Hemas' operations are constrained by regulatory pressure from price controls in its pharmaceutical business and cost escalation in the FMCG sector, where cost pass-through to the end-customer may take time. We forecast Hemas to maintain a better financial risk profile in the next few years with net leverage below 1.0x.

## 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 of the Sri Lankan National Rating 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 given 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 an unrestricted cash balance of LKR37.0 billion and undrawn but committed bank facilities of around LKR15 billion at end-December 2022, which can comfortably cover short-term local-currency debt maturities of about LKR4.2 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. Around 91% of Dialog's debt consisted of FC debt at end-December 2022, but most of the debt will be due after 2024.

## Liquidity and Debt Maturities

### Dialog Axiata PLC Liquidity Analysis

(LKRm)	2023	2024F	2025F	2026F
<b>Available liquidity</b>				
Beginning cash balance	37,049	28,830	34,255	-3,271
Rating case FCF after acquisitions and divestitures	-4,019	7,125	7,774	9,667
<other cash inflows post-FCF or not modeled into base case FCF>				
<e.g., debt issued since last balance sheet>				
<e.g., cash inflow from reduction in capex>				
<e.g., cash inflow from reduction in dividend>				
<b>Total available liquidity (A)</b>	<b>33,030</b>	<b>35,955</b>	<b>42,029</b>	<b>6,396</b>
<b>Liquidity uses</b>				
Debt maturities	-4,200	-1,700	-45,300	-12,000
<other uses of liquidity>				
<b>Total liquidity uses (B)</b>	<b>-4,200</b>	<b>-1,700</b>	<b>-45,300</b>	<b>-12,000</b>
<b>Liquidity calculation</b>				
Ending cash balance (A+B)	28,830	34,255	-3,271	-5,604
Revolver availability	0	0	0	0
<b>Ending liquidity</b>	<b>28,830.2</b>	<b>34,255.1</b>	<b>-3,271.3</b>	<b>-5,604.1</b>
Liquidity score (x)	7.9	21.2	0.9	0.5

F - Forecast.

Source: Fitch Ratings, Fitch Solutions, Dialog Axiata PLC

<b>Scheduled debt maturities</b>	<b>2022</b>
<b>(LKRm)</b>	
2023	4,200
2024	1,700
2025	45,300
2026	12,000
2027	27,800
Thereafter	12,590
<b>Total</b>	<b>103,590</b>

Source: Fitch Ratings, Fitch Solutions, Dialog Axiata PLC

## Key Assumptions

### Fitch's Key Assumptions within our Rating Case for the Issuer

- Revenue to rise by 9%-10% over 2023-2024
- EBITDA margin of 30%-32% over 2023-2024
- Capex/revenue of around 27% over 2023-2024 to be spent mainly on 4G expansion
- Effective tax rate of 2.0% of revenue
- Dividend of around 50% of previous year's net income as per the company's policy to be paid over 2024-2026
- Effective interest rate to climb to 10%-11% over 2023-2024 with a shift towards high-cost domestic debt
- Subsidiary Dialog Finance PLC's (AA(lka)/Stable) 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 LKR1.1 billion in 2023, LKR2.2 billion in 2024 and LKR4.5 billion in 2025.

## Financial Data

### Dialog Axiata PLC

(LKRm)	Historical			Forecast		
	2020	2021	2022	2023	2024	2025
<b>Summary income statement</b>						
Gross revenue	119,905	141,644	177,463	193,422	214,359	234,157
Revenue growth (%)	2.8	18.1	25.3	9.0	10.8	9.2
EBITDA (before income from associates)	49,851	57,309	49,885	57,737	68,450	86,468
EBITDA margin (%)	41.6	40.5	28.1	29.9	31.9	36.9
EBITDAR	49,851	57,309	49,885	57,737	68,450	86,468
EBITDAR margin (%)	41.6	40.5	28.1	29.9	31.9	36.9
EBIT	16,154	23,668	7,616	10,485	18,933	34,168
EBIT margin (%)	13.5	16.7	4.3	5.4	8.8	14.6
Gross interest expense	-1,678	-1,406	-4,543	-7,272	-6,897	-6,032
Pretax income (including associate income/loss)	13,974	19,125	-30,817	8,770	16,291	31,409
<b>Summary balance sheet</b>						
Readily available cash and equivalents	14,076	21,331	37,048	28,371	32,728	30,833
Debt	40,425	41,835	103,589	99,389	97,689	90,389
Lease-adjusted debt	40,425	41,835	103,589	99,389	97,689	90,389
Net debt	26,349	20,504	66,541	71,018	64,961	59,556
<b>Summary cash flow statement</b>						
EBITDA	49,851	57,309	49,885	57,737	68,450	86,468
Cash interest paid	-1,602	-1,919	-2,488	-7,272	-6,897	-6,032
Cash tax	-1,636	-1,664	-5,976	-2,148	-2,256	-2,369
Dividends received less dividends paid to minorities (inflow/(out)flow)	—	—	—	0.0	0.0	0.0
Other items before FFO	1,601	-5,058	-7,350	0.0	0.0	0.0
Funds flow from operations	48,713	49,132	36,031	53,873	63,551	81,340
FFO margin (%)	40.6	34.7	20.3	27.9	29.6	34.7
Change in working capital	-8,028	2,984	18,257	-5,069	4,561	-4,214
Cash flow from operations (Fitch defined)	40,685	52,116	54,289	48,804	68,113	77,126
Total non-operating/nonrecurring cash flow	—	—	—	—	—	—
Capex	-19,541	-33,962	-59,842	—	—	—
Capital intensity (capex/revenue) (%)	16.3	24.0	33.7	—	—	—
Common dividends	-4,316	-6,068	-10,168	—	—	—
Free cash flow	16,827	12,085	-15,721	—	—	—
Net acquisitions and divestitures	4	166	-238	—	—	—
Other investing and financing cash flow items	-61	340	610	—	—	—
Net debt proceeds	-9,155	-8,261	31,052	-4,200	-1,700	-7,300
Net equity proceeds	12.1	-8	5	0.0	0.0	0.0
Total change in cash	7,627	4,322	15,717	-8,677	4,357	-1,894
<b>Leverage ratios (x)</b>						
EBITDA leverage	0.8	0.7	2.1	1.7	1.4	1.0
EBITDA net leverage	0.5	0.4	1.3	1.2	0.9	0.7
EBITDAR leverage	0.8	0.7	2.1	1.7	1.4	1.0
EBITDAR net leverage	0.5	0.4	1.3	1.2	0.9	0.7
EBITDAR net fixed charge coverage	45.2	39.4	94.8	33.7	25.9	31.3
FFO adjusted leverage	0.8	0.8	2.8	1.8	1.5	1.1
FFO adjusted net leverage	0.5	0.4	1.8	1.3	1.0	0.7
FFO leverage	0.8	0.8	2.8	1.8	1.5	1.1
FFO net leverage	0.5	0.4	1.8	1.3	1.0	0.7
<b>Calculations for forecast publication</b>						
Capex, dividends, acquisitions and other items before FCF	-23,853	-39,864	-70,249	-52,823	-60,988	-69,352
Free cash flow after acquisitions and divestitures	16,832	12,252	-15,960	-4,018	7,125	7,773
Free cash flow margin (after net acquisitions) (%)	14.0	8.7	-9.0	-2.1	3.3	3.3

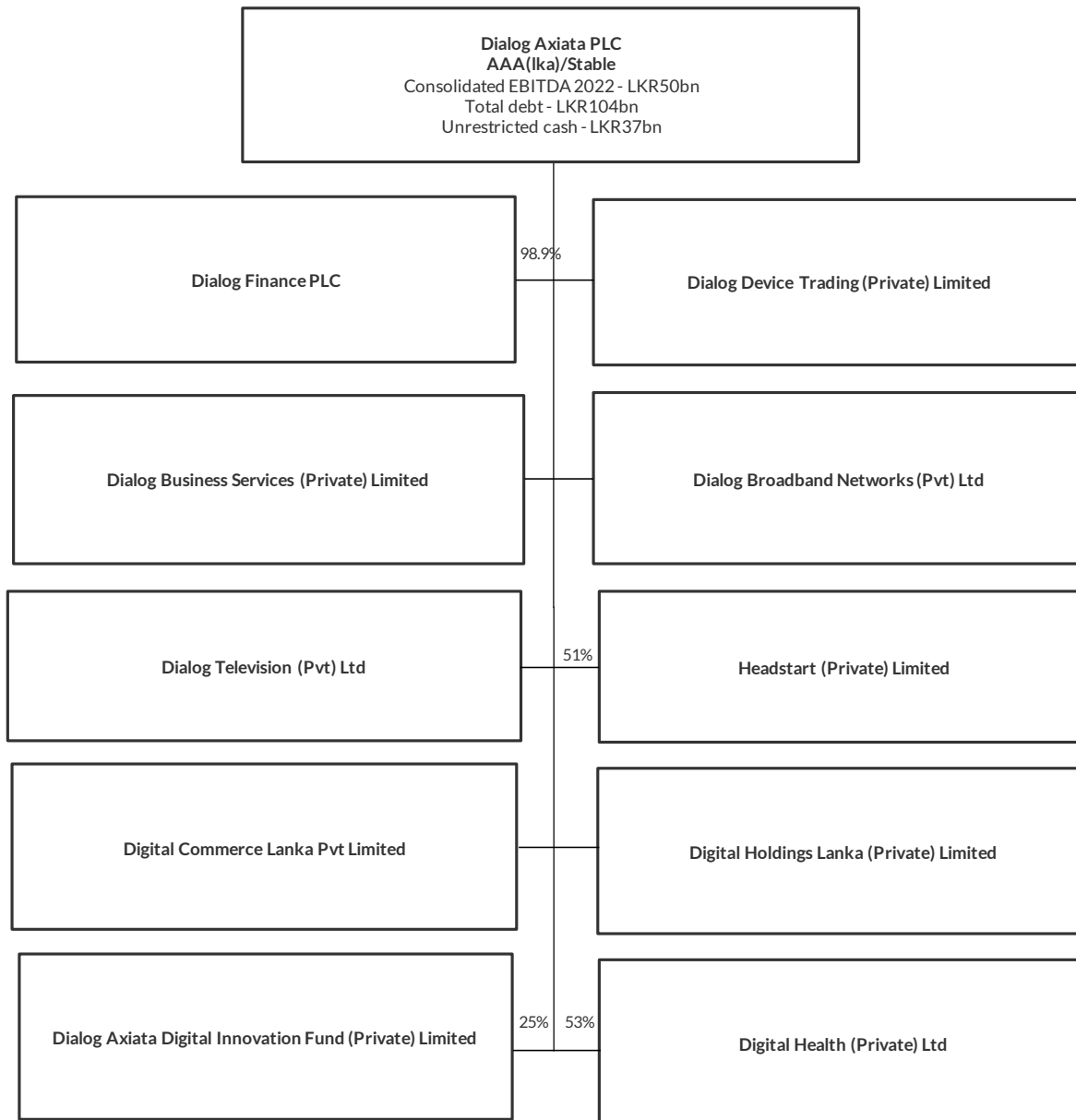
(LKRm)	Historical			Forecast		
	2020	2021	2022	2023	2024	2025
<b>Coverage ratios (x)</b>						
FFO interest coverage	31.1	26.3	14.7	7.6	9.6	13.9
FFO fixed charge coverage	31.1	26.3	14.7	7.6	9.6	13.9
EBITDAR fixed charge coverage	31.1	29.9	20.0	7.9	9.9	14.3
EBITDA interest coverage	31.1	29.9	20.0	7.9	9.9	14.3
<b>Additional metrics</b>						
CFO-capex/debt (%)	52.3	43.4	-5.4	-4.0	10.7	16.4
CFO-capex/net debt (%)	80.2	88.5	-8.3	-5.7	16.1	24.8
CFO/capex (%)	208.2	153.5	90.7	92.4	118.1	123.7

Source: Fitch Ratings, Fitch Solutions, Dialog Axiata PLC

#### How to Interpret the Forecast Presented

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## Simplified Group Structure Diagram



Source: Fitch Ratings, Fitch Solutions, Dialog, as of end-December 2022

## Peer Financial Summary

	National long-term Rating	Financial statement date	EBITDA (LKRm)	EBITDA margin (%)	Free cash flow (LKRm)	EBITDA net leverage (x)	EBITDA interest coverage (x)
Dialog Axiata PLC	AAA(lka)						
		2022	49,885	28	-15,722	1.3	20.0
		2021	57,309	40	12,086	0.4	29.9
		2020	49,851	42	16,828	0.5	31.1
Sri Lanka Telecom PLC	A(lka)						
		2021	37,382	37	12225	0.9	5.5
		2020	32,049	35	13552	1.4	4.0
		2019	26,334	31	-13056	2.1	3.2
Melstacorp PLC	AAA(lka)						
		FY22	18,467	25	21,877	1.4	6.2
		FY21	12,925	22	7,682	2.5	3.2
		FY20	13,828	21	-3,269	2.6	4.1
Hemas Holdings PLC	AAA(lka)						
		FY22	7,374	9	3,262	-1.3	21.4
		FY21	7,016	11	3,998	-0.4	12.2
		FY20	4,516	7	-2,762	0.6	4.9

Source: Fitch Ratings, Fitch Solutions, Company filings.



## Fitch Adjusted Financials

(LKRm)	Notes and formulas	Reported values	Sum of adjustments	CORP- lease treatment	- CORP - captive finance	Other adjustments	Adjusted values
31 December 2022							
<b>Income statement summary</b>							
Revenue		178,131	-668		-668	0	177,463
EBITDAR		47,133	2,752	-3,061	-115	5,928	49,885
EBITDAR after associates and minorities	(a)	47,133	2,752	-3,061	-115	5,928	49,885
Lease expense	(b)	0					0
EBITDA	(c)	47,133	2,752	-3,061	-115	5,928	49,885
EBITDA after associates and minorities	(d) = (a-b)	47,133	2,752	-3,061	-115	5,928	49,885
EBIT	(e)	2,568	5,048	-765	-115	5,928	7,617
<b>Debt and cash summary</b>							
Other off-balance-sheet debt	(f)	0					0
Debt <sup>b</sup>	(g)	103,590					103,590
Lease-equivalent debt	(h)	0					0
Lease-adjusted debt	(i) = (g+h)	103,590					103,590
Readily available cash and equivalents	(j)	39,936	-2,887		-2,887	-0	37,049
Not readily available cash and equivalents		611					611
<b>Cash flow summary</b>							
EBITDA after associates and minorities	(d) = (a-b)	47,133	2,752	-3,061	-115	5,928	49,885
Preferred dividends (paid)	(k)	0					0
Interest received	(l)	1,962					1,962
Interest (paid)	(m)	-2,488					-2,488
Cash tax (paid)		-5,976					-5,976
Other items before FFO		-2,235	-5,115	765	48	-5,928	-7,351
Funds from operations (FFO)	(n)	38,395	-2,363	-2,296	-67	0	36,032
Change in working capital (Fitch-defined)		18,258					18,258
Cash flow from operations (CFO)	(o)	56,653	-2,363	-2,296	-67	-0	54,290
Non-operating/nonrecurring cash flow		0					0
Capital (expenditures)	(p)	-59,843					-59,843
Common dividends (paid)		-10,169					-10,169
Free cash flow (FCF)		-13,359	-2,363	-2,296	-67	-0	-15,722
<b>Gross leverage (x)</b>							
EBITDAR leverage <sup>a</sup>	(i/a)	2.2					2.1
FFO adjusted leverage	(i)/(n-m-l-k+b))	2.7					2.8
FFO leverage	(i-h)/(n-m-l-k)	2.7					2.8
EBITDA leverage <sup>a</sup>	(i-h)/d	2.2					2.1
(CFO-capex)/debt (%)	(o+p)/(i-h)	-3.1%					-5.4%
<b>Net leverage (x)</b>							
EBITDAR net leverage <sup>a</sup>	(i-j)/a	1.4					1.3
FFO adjusted net leverage	(i-j)/(n-m-l-k+b)	1.6					1.8
FFO net leverage	(i-h-j)/(n-m-l-k)	1.6					1.8
EBITDA net leverage <sup>a</sup>	(i-h-j)/d	1.4					1.3
(CFO-capex)/net debt (%)	(o+p)/(i-h-j)	-5.0%					-8.3%
<b>Coverage (x)</b>							
EBITDAR fixed charge coverage <sup>a</sup>	a/(-m+b)	18.9					20.0
EBITDA interest coverage <sup>a</sup>	d/(-m)	18.9					20.0
FFO fixed-charge coverage	(n-l-m-k+b)/(-m-k+b)	15.6					14.7
FFO interest coverage	(n-l-m-k)/(-m-k)	15.6					14.7

<sup>a</sup>EBITDA/R after dividends to associates and minorities.

<sup>b</sup>Includes Other Off Balance Sheet Debt.

Source: Fitch Ratings, Fitch Solutions, Dialog Axiata PLC

## FX Screener

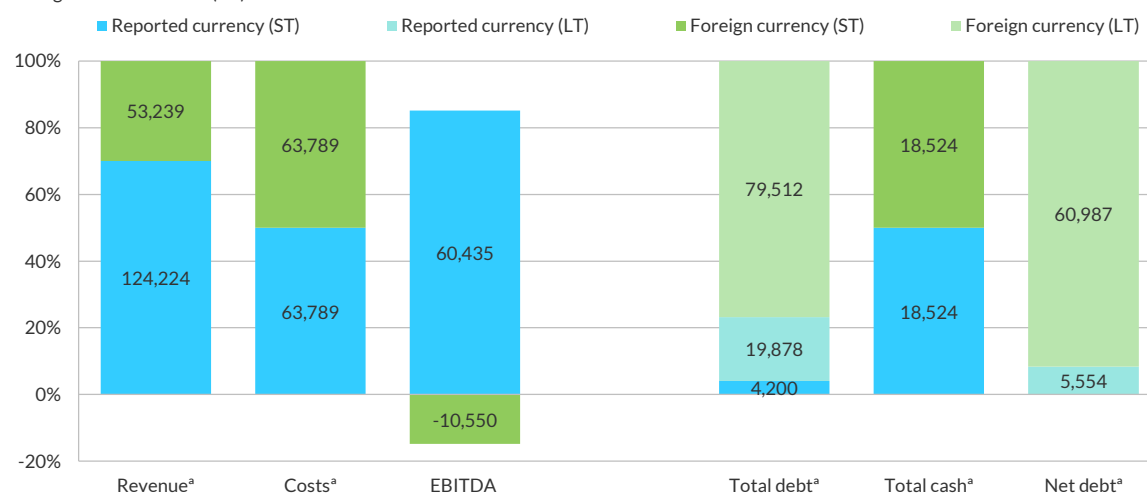
Dialog is exposed to the Sri Lankan rupee's movements relative to the US dollar because about 91% of its debt was denominated in US dollars as of end-December 2022. The company's FC debt mainly comprised a USD136 million loan from the International Finance Corporation and a USD90 million shareholder loan. The repayment of both these loans will commence only from 2025.

Dialog generates around 30% of its revenue, amounting to USD150 million, in FC, but we believe almost all of it will be used to settle the company's FC operating costs. This means the company will have to depend on its FC deposits of around USD42 million to settle FC interest costs of around USD12 million,

Dialog does not actively hedge its FC exposure as such instruments are not available in the Sri Lankan market.

### Fitch FX Screener

Dialog Axiata PLC – AAA(lka) /Stable



<sup>a</sup> Post hedge, absolute figures displayed are Fitch's analytical estimates, based on publicly available information

Source: Fitch Ratings

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