



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

Fitch Ratings-Singapore/Colombo/Sydney-23 May 2016: Fitch Ratings has affirmed Sri Lanka-based telecoms company Dialog Axiata PLC's (Dialog) 'AAA(lka)' National Long-Term Rating. The Outlook is Stable.

### KEY RATING DRIVERS

**Standalone Rating Upgraded:** We upgraded Dialog's standalone credit profile to 'AAA(lka)' from 'AA+(lka)', based on its improving financial profile backed by its continued market leadership in Sri Lanka's growing mobile and pay-TV segments. We believe resilience to foreseeable risks puts Dialog in the top-tier of Sri Lankan corporates for credit quality.

**High Ratings Headroom:** Dialog would receive potential support from its 83%-parent, Axiata Group Berhad (Axiata) of Malaysia, if its standalone credit profile were to weaken. Dialog and its parent continue to have strong operational and strategic linkages which include sharing key management personnel, a common brand name and common creditors, which could result in reputational risk to Axiata should Dialog fail.

**Rising Regulatory Risks:** The regulatory risks have risen for telcos since the new government assumed office in 2015. The government has increased taxes on telcos in an effort to shore up revenue. Effective from May 2016, the government imposed a value-added tax (VAT) of 15% and nation building tax (NBT) of 2% on telecom services which will increase tax on voice and data services to 50% and 32%, respectively (earlier: 28% and 12%).

The government had abandoned an earlier tax proposal which could have diluted the industry's EBITDA margin by an average of 6%-7%. We revised the outlook on Sri Lanka's telco sector to stable from negative on 18 January 2016 following the new government budget.

**Stagnant Revenue; Lower Profitability:** We forecast Dialog's revenue to decline by the low-single-digits as voice and data usage could ease off following the tax increase. Its 2016 operating EBITDAR margin could narrow by 100bp to 33% (2015: 34%) due to lower usage and decline in profitable international voice business. This would more than offset the improving margin on data segment revenue and savings from its new Bay of Bengal undersea cable.

However, we expect Dialog's revenue to grow by the mid-single-digits during 2017-2019, driven mainly by higher data revenue and a gradual recovery in usage. Dialog's mobile data revenue grew by 64% in 2015, and accounted for around 15% of mobile revenue.

**Negative FCF; Higher Leverage:** We expect negative FCF during 2016-2018 as cash flow from operations will be insufficient to fund its large capex requirements and dividend commitments. As a result, FFO-adjusted net leverage will deteriorate marginally to 1.5x (2015: 1.2x) during 2016-2017. Dialog would be likely to increase its 2016-2017 capex to 30% of revenue (2015: 23%) to expand 3G/4G networks and fibre infrastructure. Dividends are likely to be around LKR2bn-2.5bn in 2016 and 2017.

**Industry to Consolidate:** The tax increases might accelerate industry consolidation to reduce the number of telcos to three from five. Two smaller, unprofitable operators - Hutchison Lanka and Bharti Airtel Limited's (BBB-/Stable) Sri Lanka subsidiary, Airtel Lanka - may exit the industry.

We believe that Dialog and Sri Lanka Telecom PLC (B+/Negative) could acquire smaller telcos to strengthen their market position and consolidate spectrum. Dialog's ratings have sufficient headroom for a debt-funded acquisition of a smaller telco for around LKR10bn-12bn.

**Adequate Liquidity:** Dialog's cash balance of LKR9.7bn and committed undrawn facilities of LKR7bn were sufficient at end-March 2016 to meet its short-term debt maturities of LKR8bn. The company has solid access to local banks, given that it is one of the largest corporates in Sri Lanka. Its debt consists of a USD149m syndicated facility and LKR10bn bank loan. We expect Dialog's future borrowings to be in Sri Lankan rupees to mitigate forex risk.

#### KEY ASSUMPTIONS

- Revenue to contract by 1%-2% in 2016 as usage declines due to higher taxes. Revenue growth will recover to the high-single-digit percentages during 2017-2019.
- Operating EBITDAR margin to be diluted by about 100bp in 2016, but to recover in 2017.
- Capex/revenue to increase to around 30% on account of fibre and 3G/4G network expansion.
- FCF deficit during 2016-2018 resulting in a gradual increase in FFO-adjusted net leverage.

#### RATING SENSITIVITIES

**Negative:** Future developments that may individually, or collectively, lead to negative rating action include:

- A significant dilution in Axiata's ownership or board control in Dialog, removal of the common brand name, or a weakening of the current strategic and operational ties between the companies.
- A narrowing in operating EBITDAR margin to below 20%, along with FFO-adjusted net leverage above 3.5x on a sustained basis, could weaken its standalone credit profile.

**Positive:** Future developments that may individually or collectively lead to positive rating action include:

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

#### Contact:

Primary Analyst  
Nitini Soni  
Director  
+65 6796 7235  
Fitch Ratings Singapore Pte Ltd  
6 Temasek Boulevard  
#35-05 Suntec City Tower 4  
Singapore 038986

Secondary Analyst  
Kanishka De Silva  
+ 94 11 254 1900

Committee Chairperson  
Steve Durose  
Managing Director

+61 2 8256 0307

Media Relations: Leslie Tan, Singapore, Tel: +65 67 96 7234, Email: [leslie.tan@fitchratings.com](mailto:leslie.tan@fitchratings.com); Wai-Lun Wan, Hong Kong, Tel: +852 2263 9935, Email: [wailun.wan@fitchratings.com](mailto:wailun.wan@fitchratings.com).

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com).

### Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015) ([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=869362&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI))

National Scale Ratings Criteria (pub. 30 Oct 2013) ([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=720082&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=720082&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI))

National Scale Ratings Criteria (pub. 30 Oct 2013)

([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=720082&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=720082&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI))

([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=720082&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=720082&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjQxMDIzOTYsInNlc3Npb25LZXkiOiJXNUFCUDIJTlJOOVpNMU1SOVRVT0RXODdUUUpSSzIFU09BWFZCRDZWIn0.2KwY8tvXS62QE0VsUgb8jgcl40CotdM0TGcmYf9fDMI))

### Additional Disclosures

Solicitation Status ([https://www.fitchratings.com/gws/en/disclosure/solicitation?pr\\_id=1004921](https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1004921))

Endorsement Policy (<https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS)

(<http://fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

**Endorsement Policy** - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.