May 11, 2023

CtrlS Datacenters Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans	537.90	1323.98	[ICRA]AA-(Stable); reaffirmed/assigned
Non-fund based facilities	40.00	100.00	[ICRA]AA-(Stable); reaffirmed/assigned
Unallocated limits	172.10	226.02	[ICRA]AA-(Stable) / [ICRA]A1+; reaffirmed/assigned
Total	**750.00**	**1650.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation of CtrlS Datacenters Limited (CtrlS) factors in healthy capacity utilisation of existing and newly operational data centres (DCs), reputed and diversified customer base with high client stickiness, strong financial profile with expected healthy revenue growth and comfortable debt coverage metrics in FY2024.

The company witnessed robust growth in revenues at a CAGR of 25% (FY2019 – FY2023) to ~Rs. 1,120 crore in FY2023 on the back of rack capacity addition, improvement in capacity utilisation and increase in lease rates. The revenues are expected to grow by 20-25% Year-on-Year (YoY) in FY2024, backed by ramp up in utilisation of new facilities. With better absorption of fixed costs, the operating margins are estimated to remain healthy at 55% in FY2023 and expected to improve by 100-200 bps in FY2024, thereby resulting in healthy return on capital employed (RoCE). The ratings note the company's strong financial profile, characterised by comfortable leverage and healthy debt coverage indicators. Due to its large debt-funded capex in FY2024, the Net Debt (excluding lease liabilities)/OPBITDA is expected to increase to around 1.8-1.9 times. However, the coverage indicators remained strong with projected DSCR of 4.5-4.7 times in FY2024 owing to the longer tenure of the debt. Further, the company enjoys high financial flexibility, given that the current borrowings are against 20% of the rental inflows, thereby leaving 80% of the unencumbered inflows to CtrlS.

The ratings continue to factor in the reputed and diversified customer base across different verticals and the Tier-IV nature of the DCs, with 99.995% uptime, which enables CtrlS to command premium pricing than DCs with lower tier structures. The large investments made by customers and the downtime risks associated with shifting ensure high customer stickiness in the DC business, evident from its long-term relationships with the customers. The ratings consider strong demand prospects for DCs in the long term, backed by digital data explosion in India and favourable regulatory support initiatives.

The ratings are, however, constrained by the company's large capex plans in the medium term. During FY2024-FY2025, CtrlS is expected to incur a capex of Rs. 2,000-2,500 crore, primarily towards setting up of DCs in Mumbai, Chennai and Hyderabad and solar power project for captive consumption. This capex is expected to be funded by a debt of Rs. 750-1000 crore and the balance through internal accruals. Its ability to ramp-up utilisation in the new DCs, while maintaining healthy profitability and RoCE, remains to be seen. The ratings are also constrained by the heightened competition from large DC additions with entry of many new players in the segment and expansion plans from existing players. While the high uptime of CtrlS' DCs and customer stickiness, along with the long-standing strategic relationships with its customers, provide competitive advantage in the existing business, the increased competition could exert pressure on the operating margin of incremental business. CtrlS faces significant industry risks as DC business models continue to evolve and have relatively high capital intensity nature of business. ICRA notes that although CtrlS has adequate insurance cover to handle any liabilities that may arise due to data loss and fire accidents, the company remains exposed to reputation risk. Any significant financial support extended to Group companies will be a key rating monitorable.

The Stable outlook on the long-term rating reflects ICRA's belief that the company would benefit from its strong financial profile, healthy demand prospects for the sector and reputed client base.

Key rating drivers and their description

Credit strengths

Healthy growth in scale of operations and robust profitability – CtrlS witnessed a robust growth in its OI (CAGR of 25%) over the last five years (FY2019-FY2023) to ~Rs. 1,120 crore in FY2023 on the back of new long-term leases, rack addition, increase in lease rates and better utilisation. The revenues are expected to grow by 20-25% YoY in FY2024, backed by ramp up in utilisation of new facilities. With better absorption of fixed costs, the operating margins are estimated to remain healthy at 55% in FY2023 and expected to improve by 100-200 bps in FY2024, thereby resulting in healthy return on capital employed (RoCE). The company has a reputed and diversified customer base across different verticals as on December 31, 2022; the top-10 customers contributed 64.6% of revenues in 9M FY2023. The large investments made by customers and the downtime risks associated with shifting ensure high customer stickiness in DC business, evident from the long-term relationships with its customers.

Strong financial profile – The company's financial profile is strong, characterised by comfortable leverage with Net Debt (excluding lease liabilities)/OPBIDTA at estimated 1.2-1.3 times in FY2023 and TOL/TNW at estimated 1.3-1.35 times, healthy debt coverage indicators with debt service coverage at estimated 3-3.5 times and interest coverage of estimated 6-6.5 times as on March 31, 2023. Due to the large debt-funded capex in FY2024, the Net Debt (excluding lease liabilities)/OPBITDA is expected to increase to around 1.8-1.9 times. However, the coverage indicators are likely to remain strong, with projected DSCR of 4.5-4.7 times in FY2024 owing to the longer tenure of the debt. Further, it enjoys high financial flexibility, given that the current borrowings are against 20% of the rental inflows, thereby leaving 80% of unencumbered inflows to CtrlS. For the term debt, the company maintains an escrow account, with liquidity buffer of one month of debt obligation in the form of DSRA.

Favourable regulations support long-term prospects of DC – Data localisation and explosion are paving the way for a DC revolution in India. The key triggers for digital explosion in India are the increasing internet and mobile penetration, the Government's thrust on e-governance/digital India, adoption of new technologies (cloud computing, IoT, 5G, etc), growing userbase for social media, gaming, e-commerce and OTT platforms. This, coupled with favourable regulatory policies viz., the draft Digital Data Protection Bill 2022, providing infrastructure status to data centres, special incentives from Central and state governments like land at subsidised cost, power subsidies, exemptions on stamp duty, discounts on usage of renewable energy and procurement of IT components made locally, and other concessions, are expected to boost DC investments in the country.

Credit challenges

Large capex plans in medium term – During FY2024-FY2025, CtrlS is expected to incur a capex of Rs. 2000-2500 crore, primarily towards setting up of DCs (in Mumbai, Chennai and Hyderabad), and solar power project for captive consumption. The capex is likely to be funded by a debt of Rs. 750-1000 crore and the balance through internal accruals. The company's ability to ramp-up utilisation of the new DCs, while maintaining healthy profitability and RoCE, remains to be seen.

Stiff competition from other players – The company faces heightened competition from large DC additions with entry of many new players in the segment and expansion plans from existing players. While the high uptime of CtrlS' DCs and customer stickiness, along with the long-standing strategic relationships with its customers, provide competitive advantage in existing business, the increase in competition could exert pressure on the operating margins of incremental business.

Exposure to reputation risk – Although CtrlS is adequately covered with insurance to handle any liabilities that may arise due to data loss and fire accidents, the company remains exposed to reputation risk.

Liquidity position: Adequate

The company's liquidity position is adequate, with an unencumbered cash balance of Rs. 264.4 crore as on March 31, 2023. The debt repayment of Rs. 44.4 crore for FY2024 can be comfortably met through estimated cash flow from operations. The capex for FY2024 is estimated to be ~Rs. 1,200 crore (against which it has undrawn term loans of Rs. 360 crore), which is expected to be funded by a debt of Rs. 600-700 crore and the balance through internal accruals. For the term debt, the company maintains an escrow account, with liquidity buffer of one month of debt obligation (average) in the form of DSRA.

Rating sensitivities

Positive factors – ICRA may upgrade the ratings if there is a significant increase in revenues while maintaining profitability levels. Specific credit metrics that could lead to a rating upgrade include Net Debt/EBITDA of less than 0.75 times and DSCR of more than 3.5 times on a sustained basis.

Negative factors – Negative pressure on the ratings may arise if there is steep decline in revenues and profitability or any higher-than-anticipated debt-funded capex or elongation in receivable cycle resulting in weakening of liquidity and coverage indicators. Specific credit metrics that could lead to a downgrade of ratings include Net Debt/EBITDA of more than 2.0 times and/or DSCR less than 2.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology Hardware – related Services Industry
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

CtrlS Datacenters Limited (CtrlS) was incorporated in 2008 and the first DC started in Hyderabad in 2009. The company provides infrastructure for dedicated hosting and co-location services to global and domestic customers. At present, the company has nine operational data centres at four locations – Mumbai (5), Hyderabad (2), Noida and Bengaluru. While the Hyderabad (Madhapur), Mumbai (5) and Noida DCs are owned and managed by CtrlS, the Bengaluru and Hyderabad (Gachibowli) DCs are managed by CtrlS and are operated on a revenue-sharing model. All the nine current DCs of CtrlS are Tier IV, ensuring 99.995% availability. The major customer segments of the company are banking, financial service and insurance (BFSI), e-commerce, telecom companies, Government bodies, IT companies, etc.

Key financial indicators

CTRLS	FY2021	FY2022	9M FY2023
	Audited	Audited	Provisional
Operating income	780.2	932.9	819.5
PAT	234.4	286.4	250.7
OPBDIT/OI	58.6%	57.4%	54.4%
PAT/OI	30.0%	30.7%	30.6%
Total outside liabilities/Tangible net worth (times)	1.1	1.0	1.3
Total debt/OPBDIT (times)	1.1	1.2	2.1
Interest coverage (times)	9.1	10.9	6.0

Source: Company data, ICRA Research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of March 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & Rating in FY2022		Date & rating in FY2021
					May 11, 2023	Aug 29, 2022	June 18, 2021	May 24, 2021	-
1	**Term Loans**	Long-term	1323.98	971.3	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	-
2	**Non-fund-based Limits**	Long-term	100.00	-	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	-
3	**Unallocated Limits**	Long-term and Short term	226.02	-	**[ICRA]AA-(Stable)/ [ICRA]A1+**	**[ICRA]AA-(Stable)/ [ICRA]A1+**	**[ICRA]AA-(Stable)/ [ICRA]A1+**	**[ICRA]AA-(Stable)/ [ICRA]A1+**	-
4	**Fund based-Working Capital Facilities**	Long-term	-		-	-	**[ICRA]AA-(Stable)**	**[ICRA]AA-(Stable)**	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loans	Simple
Non-fund Based Facilities	Very Simple
Unallocated Limits	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here]

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loans**	March 2020	NA	Dec 2036	1323.98	[ICRA]AA-(Stable)
NA	**Non-fund Based Facilities**	NA	NA	NA	100.00	[ICRA]AA-(Stable)
NA	**Unallocated Loans**	NA	NA	NA	226.02	[ICRA]AA-(Stable)/[ICRA]A1+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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About ICRA Limited:

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