ICRA

July 13, 2020

Netmagic IT Services Private Limited: [ICRA]A1+ assigned for commercial paper programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	1174.69	1174.69	[ICRA]AA+(Stable); Outstanding
Fund Based – Working Capital Facilities	205.00	205.00	[ICRA]A1+; Outstanding
Non-fund Based Limits	16.00	16.00	[ICRA]A1+; Outstanding
Unallocated Limits	4.31	4.31	[ICRA]AA+(Stable); Outstanding
Commercial Paper	-	400.00	[ICRA]A1+; Assigned
Total	**1400.00**	**1800.00**	

**Instrument details are provided in Annexure-1*

Rationale

While arriving at the ratings, ICRA has considered the consolidated financials of Netmagic IT Services Private Limited (NMIT) and Netmagic Solutions Private Limited (NSPL), together referred to as the Netmagic Group, given their strong operational, financial and managerial linkages.

The ratings reflect the strong parentage of the Netmagic Group, a wholly owned step-down subsidiary of Nippon Telegraph and Telephone Corporation (NTT), rated by Moody's at A1 (Stable). NTT is a leading integrated telecom operator in Japan with Japan's Ministry of Finance holding about 34.69% (as on March 31, 2020) of the ownership in the company. The Netmagic Group has a long track record of funding support from NTT. The consolidated operating income of the Group grew at a healthy CAGR of ~28.8% over the five-year period of FY2015-FY2019 aided by rack additions with opening of new data centers at Mumbai (Maharashtra) and Bangalore (Karnataka). The financial profile of the Group is strong characterized by comfortable capital structure, with gearing of 0.3 times as on December 31, 2019 and healthy debt coverage indicators with interest coverage of 8.3 times in 9MFY2020 and DSCR of 2.5 times in 9MFY2020. However, ICRA notes that the Group is in the midst of a large debt funded capex program for its data center expansion process; with this leverage is expected to increase now thus impacting the Group's debt coverage metrics. The ratings further draw comfort from the well-diversified customer base spread across different verticals viz. media, services, information technology and information technology enabled services (IT & ITES), banking financial services and insurance (BFSI), telecommunication etc. with top 10 customers contributing to ~42% of overall consolidated revenue in 9MFY2020. The large investments made by customers and the downtime risks associated with shifting result in high customer stickiness in the data centre business, evident from the Group's long-term relationship with its customers. Further, demand for data centers has been improving since RBI's regulation dated April 2018 on data localisation directing payment system operators to store all data, including full end-to-end transaction details, within India to ensure security of users' information. The data center business provides a stable annuity stream of inflows wherein the customers enter into medium to long term service contracts with defined rates to utilise Netmagic's data centers and related IT infrastructure services.

The ratings are, however, constrained by high receivable cycle with debtor days at 86 days as on December 31, 2019; of these around 23% of the total receivables are pending for more than six months. The approval process for the bills remains elongated due to the technical nature of services requiring coordination with multiple client-side teams for the approval of invoices. The rating is also constrained on account of modest return on capital employed at 6.0% in FY2019 on account of underutilization of some of the Group's data center facilities and the continuous large capex incurred over the last five years. However, ICRA notes that the order pipeline for the upcoming data center at Mumbai is strong. The rating also factors in the high competition from other established players such as CtrlS Datacenters Limited (rated [ICRA]A+ (Stable)/A1+), Sify Technologies Limited (rated [ICRA]A+ (Stable)/A1+) and ST Telemedia Global Data Centres. However, the long-term relationship, competitive pricing and strong technology support from NTT provide the Netmagic Group a competitive advantage to some extent. ICRA notes that although the company's financial liability in cases of service deficiency is limited, the company remains exposed to reputation risk. ICRA notes that the commercial paper issuance would be used as a bridge finance to fund the construction of two new datacentres in Mumbai. As per the earlier plan, these data centres were to be housed under special purpose vehicles setup by NTT through a Singapore based investment platform. Due to the procedural delays in setting up the SPVs owing to Covid-19, the group decided to raise funds through CP issuances as an interim measure to start the construction activity in order to meet the tight delivery commitments to its clients.

Key rating drivers and their description

Credit strengths

Strong Parentage – The Netmagic Group is a wholly owned step-down subsidiary of Nippon Telegraph and Telephone Corporation (NTT), rated by Moody's at A1 (Stable). NTT is a leading integrated telecom operator in Japan with Japan's Ministry of Finance holding about 34.69% (as on March 31, 2020) of the ownership in the company. There is a demonstrated track record of funding support from NTT to Netmagic Group.

Stable annuity stream of inflows – The data center business provides a stable annuity stream of inflows wherein the customers enter into medium to long term service contracts with defined rates to utilise Netmagic's data centers and related IT infrastructure services.

Strong financial profile – The consolidated operating income of the Group grew at a healthy CAGR of ~28.8% over the five-year period of FY2015-FY2019 aided by rack additions with opening of new data centers at Mumbai and Bangalore. The financial profile of the Group is strong characterized by comfortable capital structure, with gearing of 0.3 times as on December 31, 2019 and healthy debt coverage indicators with interest coverage of 8.3 times in 9MFY2020 and DSCR of 2.5 times in 9MFY2020.

Reputed and diversified client base with high customer stickiness – The Group has a well-diversified customer base spread across different verticals viz. media, services, information technology and information technology enabled services (IT & ITES), banking financial services and insurance (BFSI), telecommunication etc. with top 10 customers contributing to ~42% of overall consolidated revenue in 9MFY2020. The large investments made by customers and the downtime risks associated with shifting result in high customer stickiness in the data center business, evident from the Group's long-term relationship with its customers.

Favourable regulations support long-term prospects of data center business - Demand for data centers has been improving since RBI's regulation dated April 2018 on data localisation directing payment system operators to store all data, including full end-to-end transaction details, within India to ensure security of users' information.

Credit challenges

High receivable cycle – The ratings are constrained by high receivable cycle with debtor days at 86 days as on December 31, 2019; of these around 23% of the total receivables are pending for more than six months. The approval process for the bills remains elongated due to the technical nature of services requiring coordination with multiple client-side teams for the approval of invoices.

Continuous capex leading to modest return indicators – The underutilization of some of the Group's data center facilities and the continuous large capex incurred over the last five years have led to modest return on capital employed at 6.0% in FY2019. However, ICRA notes that the order pipeline for the upcoming data center at Mumbai is strong.

Stiff competition from other players – Netmagic Group faces high competition from other established players such as CtrlS Datacenters Limited, Sify Technologies Limited and ST Telemedia Global Data Centres. However, the long-term relationship, competitive pricing and strong technology support from NTT provide the Group a competitive advantage to some extent.

Exposure to reputation risk – Although the company's financial liability in cases of service deficiency is limited, the company remains exposed to reputation risk.

Liquidity position: Adequate

The liquidity position of the company is adequate with unencumbered cash balance of ~Rs. 56.9 crore as on May 31, 2020 and average fund-based utilization of ~70% for the fifteen-month period of April 2019 to June 2020 with average cushion of ~Rs. 62 crore. The debt repayment of Rs. 59.25 crore for FY2021 can be comfortably met through cash flow from operations. The capex for FY2021 (excluding construction of the two new data centres in Mumbai which is funded through bridge financing) is estimated to at ~Rs. 330 crore and is expected to be funded through a mix of term loans and internal accruals.

Rating sensitivities

Positive triggers – The crystallisation of scenarios for rating upgrade is unlikely over the medium term. Nevertheless, in case if the company achieves optimal capacity utilisation of existing and new data centers under construction resulting in significant ramp up in revenues while improving its profitability along with reduction in receivable cycle, could be a positive trigger. Specific credit metrics that could lead to a rating upgrade include DSCR of more than 4.0 times and ROCE of more than 25% on a sustained basis.

Negative triggers – Negative pressure on the ratings may arise if higher-than-anticipated debt-funded capex or further elongation in receivable cycle weakens the coverage indicators or if there is sustained lower utilization levels of new data centers and/or if there is weakening of linkages with NTT. Specific credit metric that could lead to a downgrade of ratings includes DSCR of less than 2.0 times.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology Hardware-related Services Industry Impact of implicit support expected from parent or group on an entity's credit rating
Parent/Group Support	Parent Company: Netmagic Solutions Private Limited Ultimate Parent Company: Nippon Telegraph and Telephone Corporation (NTT) The rating assigned to NMIT factors in the likelihood of its ultimate parent, NTT, extending financial support to it because of close business linkages between them. We also expect NTT to be willing to extend financial support to NMIT out of its need to protect its reputation from the consequences of a group entity's distress.
Consolidation/Standalone	Given the strong managerial, financial and operational linkages between Netmagic IT Services Private Limited and Netmagic Solutions Private Limited, ICRA has considered the consolidated financials of Netmagic Solutions Private Limited and Netmagic IT Services Private Limited

About the company

Netmagic IT Services Private Limited was incorporated in 2005 and is fully owned by Netmagic Solutions Private Limited, a wholly owned subsidiary of NTT Communications Corporation (NTT Com). NTT Com, 100% held by Japan's Nippon Telegraph and Telephone Corporation (NTT-rated by Moody's at A1 (Stable)), is a global provider of Information and communications technology solutions (ICT) within the NTT Group. NMIT provides data center co-location services, cloud services and dedicated hosting or managed services to customers across India. It currently has 9 operational data centers across four locations – Mumbai (5), Noida (1), Chennai (1) and Bangalore (2). The company has a well-diversified customer base spread across different verticals viz. media, services, information technology and information technology enabled services (IT & ITES), banking financial services and insurance (BFSI), telecommunication etc.

Key financial indicators (consolidated)

	FY2019 (Audited)	9MFY2020(Provisional)
Operating Income (Rs. crore)	931.8	843.2
PAT (Rs. crore)	47.1	53.5
OPBDIT/OI (%)	24.2%	27.9%
PAT/OI (%)	5.1%	6.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.6
Total Debt/OPBDIT (times)	1.1	1.9
Interest Coverage (times)	8.0	8.3

Source: NMIT, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY20201)				
		Type	Amount Rated	Amount Outstanding	Rating 13-July-2020	Rating 3-April-2020
1	Term Loan	Long Term	1174.69	674.69*	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2	Fund Based – Working Capital Facilities	Short Term	205.00	-	[ICRA]A1+	[ICRA]A1+
3	Non-Fund Based Limits	Short Term	16.00	-	[ICRA]A1+	[ICRA]A1+
4	Unallocated Limits	Long Term	4.31	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
5	Commercial Paper	Short Term	400.00	-	[ICRA]A1+	-

Amount in Rs. Crore

**As on March 2020, out of the Rs. 1174.69 crore of term loans, Rs. 674.69 crore of term loans are outstanding and Rs. 500 crore of term loans are yet to be fully drawn down*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan – 1	June 2015	-	August 2020	8.75	[ICRA]AA+ (Stable)
NA	Term Loan – 2	September 2015	-	September 2020	16.16	[ICRA]AA+ (Stable)
NA	Term Loan – 3	June 2016	-	September 2021	13.36	[ICRA]AA+ (Stable)
NA	Term Loan – 4	September 2016	-	November 2021	24.75	[ICRA]AA+ (Stable)
NA	Term Loan – 5	June 2016	-	June 2021	11.67	[ICRA]AA+ (Stable)
NA	Term Loan – 6	December 2018	-	February 2027	200.00	[ICRA]AA+ (Stable)
NA	Term Loan – 7	December 2018	-	March 2026	200.00	[ICRA]AA+ (Stable)
NA	Term Loan – 8	January 2019	-	September 2026	200.00	[ICRA]AA+ (Stable)
NA	Term Loan – 9	February 2020	-	March 2026	300.00	[ICRA]AA+ (Stable)
NA	Term Loan – 10	Yet to be drawn down	-	Yet to be drawn down	200.00	[ICRA]AA+ (Stable)
NA	Fund Based – Working Capital Facilities	-	-	-	205.00	[ICRA]A1+
NA	Non-fund Based Limits	-	-	-	16.00	[ICRA]A1+
NA	Unallocated Limits	-	-	-	4.31	[ICRA]AA+ (Stable)
NA	Commercial Paper	-	-	Yet to be placed	400.00	[ICRA]A1+

Source: NMIT

Annexure-2: List of entities considered for consolidated analysis

Given the strong managerial, financial and operational linkages between Netmagic IT Services Private Limited and Netmagic Solutions Private Limited, ICRA has considered the consolidated financials of Netmagic Solutions Private Limited and Netmagic IT Services Private Limited

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About ICRA Limited:

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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