RATING REPORT

Pakistan Telecommunication Company Limited

REPORT DATE:
October 11, 2018

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating	
Rating Category	**Long-term**	**Short-term**
Entity	AAA	A-1+
Rating Date	*October 11, 2018*	
Rating Outlook	Stable	
Outlook Date	*October 11, 2018*	

COMPANY INFORMATION

Incorporated in 1995	**External auditors:** KPMG Taseer Hadi & Co., Chartered Accountants
Public Listed Company	**Chief Executive Officer:** Daniel Ritz **Board of Directors:** - Maroof Afzal - Abdulrahim Abdulla Abdulrahim Al Nooryani - Arif Ahmed Khan - Hatem Dowidar - Serkan Okandan - Rizwan Malik - Khalifa Al Shamsi - Mudassar Hussain - Hesham Abdulla Al Qassim

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

Pakistan Telecommunication Company Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Pakistan Telecommunication Company Limited (PTCL) was incorporated in December'1995 and provides telecommunication services in Pakistan through ownership of required facilities and infrastructure with reach expanding across the country.

PTCL was privatized in 2006 through sale of Class B shares. Etisalat International Pakistan (EIP), 90% owned subsidiary of Etisalat group, being the highest bidder acquired 26% stake in PTCL with management control. Each Class B share has four voting rights for the purpose of election of directors. Majority shareholding remains with Government of Pakistan (GoP) which holds 62% of PTCL shares.

Sector Snapshot

Telecom Sector in the country is estimated to have a total revenue of around Rs. 465billion while cellular and broadband subscribers (including 3G/4G customers) have crossed 150million (teledensity: 73%) and 60million (Broadband penetration: 29%), respectively. Basic telephony subscribers stood at around 3 million. Currently, 4 Cellular mobile operators (CMOs) continue to dominate the market and generate around four-fifth of the total revenues. Data business remained the main driver of growth after voice business stagnation. While revenue growth for CMOs may emanate from increase in teledensity which is on the lower side as compared to regional peers, CMOs continues to face pricing challenges in a competitive market as reflected by low average revenue per user (ARPU) which stood at around $2 in Pakistan, compared to averages of $3.94 in South Asia and $10.94 across Asia. Going forward, JCR-VIS expects competition to remain intense and capital investment to remain elevated as CMOs expand and upgrade their network to service the exponential increase in high speed wireless data consumption. Restoration of general sales tax in its previous form might also impact industry outlook although the same is considered unlikely.

The remaining one-fifth of the revenues is generated through Local Loop, Long Distance International and Wireless Local Loop segment. The Wireline broadband segment has significant room for growth given that only 5% of the household having access to Wireline broadband vis-à-vis 48.1% average in Asia and 18% in Africa. However, strengthening network infrastructure by removing impediments, particularly right of way permissions, is considered important.

Business Segments

Pakistan Telecommunication Company Limited (PTCL) is the leading integrated Information Communication Technology (ICT) service provider in the country. The Company offers a wide array of services including Wireline Broadband and IPTV, Voice, Wireless data (EVO and Charji LTE), Digital (end-to-end solutions to corporate clients), Carrier & Wholesale and International voice services.

Subsidiaries

- **Pak Telecom Mobile Limited (Ufone) -** Ufone is a wholly owned subsidiary of PTCL with market share in terms of cellular subscribers reported at 14% at end-July'2018. PTML and PTCL also enjoy synergy benefits given the integration of a number of critical departments and collaboration through initiatives like Joint shops. Over the last few years, PTML has continued to incur losses due to significant competition translating into low ARPUs, decline in market share and sizeable depreciation expense (While Ufone continues to incur accounting loss due to depreciation, cash flow generation is satisfactory). However, during the last two quarters, operating and financial performance has depicted improvement with increase in market share, sales tax advantage (Supreme Court recently abolished general sales tax), and reduction in quantum of losses. Moreover, in order to strengthen the network infrastructure, the management plans to invest in network expansion to support future growth.
- **U Microfinance Bank Limited (U Bank) -** U Bank operates as a public limited company offering services of digital commerce and branchless banking. PTCL acquired 100% shareholding in U Bank in 2012. Post change in senior management team and revision in business strategy, U Bank has witnessed significant growth in loan and revenues. Resultantly, market share has increased to over 5% while branch network has grown to 100. As a part of group synergy initiative, the bank also plans to open new branches in collaboration with PTCL. With equity injection of Rs. 1b in

the ongoing year, U Bank is poised to continue to depict healthy growth over the medium term.

Key Rating Drivers

Strong Sponsor Profile
The assigned ratings reflect ownership structure of the Company with majority shareholding vested with Government of Pakistan. Ratings also incorporate financial profile and expertise of Etisalat Group in the telecom sector. Etisalat Group has management control and holds 26% stake in PTCL. Standard & Poor's Global and Moody's have assigned credit ratings of AA- and Aa3 on the international scale, respectively to Etisalat Group.

Leading Market Position
PTCL continues to enjoy market leadership position in most business segments that it operates. PTCL has a market share of 80% in the documented broadband segment, around 90% in the fixed line voice segment and around 30% in the wireless data segment. PTCL's share in the IP Bandwidth market stands at around 60% with Transworld being the other major player.

Widespread and integrated network infrastructure. Sizeable capital investment in the ongoing Network Transformation Project (NTP) to support future growth plans.
PTCL has the largest integrated network infrastructure spanning from Karachi to Azad Jammu & Kashmir and Khyber Pakhtunkhwa which are being serviced through over 400 exchanges across the country. Besides an extensive copper infrastructure, the total fiber deployed in PTCL's network including backbone, long-haul, subsidiary, metro and access network is more than 32,000km. Wireless network (through which PTCL provides EVO and Charji services) infrastructure also spans across major cities in Pakistan. PTCL is also a member (landing party) of four international submarine cable consortiums comprising SMW-3, SMW-4, IMEWE and AAE-1 cable. AAE-1 became operational in 2017. The Company has embarked on a NTP which entails installation of new Multi-service Access Gateway (MSAG) field exchanges (to reduce copper loop length) and around 137,000 Gigabit Passive Optical Networks (based on fiber to the home technology) lines to serve high ARPU customers. Around one-third of the NTP has been completed with full completion targeted by year-end'2019. Post completion of the NTP, PTCL will be able to provide high speed internet to around 55% of its revenue generating customers. As per management, significant reduction in customer complaints and improvement in service quality (where improvement remains a key focus area) has been noted in areas where NTP has been completed.

Despite increasing risk of product substitution from CMOs (for fixed line voice segment) and competition from OTT apps (for international business), business risk profile is supported by healthy growth outlook for broadband and corporate services segment.

- **Broadband**: Low cyclicality in sales and healthy demand outlook for Wireline broadband segment due to existing low penetration bodes well for revenue growth of the segment. However, increasing pressure from new fiber based players (low barriers to entry) having superior service quality resulting in loss of market share remains a challenge. JCR-VIS has expects PTCL to recoup lost market share with completion of NTP.
- **Voice:** Over the last few years, the traditional fixed line segment has witnessed customer erosion due to product substitution from CMOs and VoIP technologies, a trend JCR-VIS expects to continue. However, customer attrition has witnessed significant slowdown over the last 18 months. Moreover, fixed line revenues from increasing broadband subscribers is expected to support revenues.
- **Wireless:** JCR-VIS expects overall industry revenues of the wireless segment to continue to decline given technology advances and ease & convenience of hot spot connectivity. In line with industry trend, PTCL's wireless segment revenues and

customer base are expected to decline.

- **Digital Services:** Segment has depicted double digit growth over the last 18 months where PTCL's diversified product offerings (Amongst others these include Tier 3 Certified Data Centers hosting, Managed Services, Satellite Services, Smart Cloud, IT system integration projects, Managed Wifi solutions, Security and IP Surveillance Business) in addition to core connectivity business should continue to remain a growth driver.
- **Wholesale & Carrier:** Growing demand for data is expected to bode well for revenues from the segment. However, pressure on prices is expected to persist.
- **International**: During 2017, revenues from the international segment revenues increased by 8%. JCR-VIS expects revenues from the segment to witness pressure given the increasing competition from OTT apps like WhatsApp, SKYPE and VIBER. Management has entered into exclusive arrangement and partnerships such as the one with Shanghai Cooperation Organization to provide connectivity between China and major international destinations transition through Pakistan.

Operating profitability to be supported by growing revenues from broadband and corporate segment (which are expected to offset revenue declines from voice, international and wireless segment) and stable EBITDA margins.

After witnessing a decline in revenues over the last three years (2014-2017), revenues of PTCL stood at prior year level during 1HCY18 as pace of decline in revenues from voice (domestic and international) and wireless segments slowed down and was offset by healthy increase in revenues from Wireline broadband and Corporate segment. Broadband segment continues to be the largest segment in terms of revenues with contribution of the same in overall revenues increasing from 25% in 2014 to 38% in 1H18. With increase in subscribers and ARPUs (as migration to higher speeds as part of a deliberate strategy), revenues of the segment are projected to reach around half of PTCL's revenues by 2022. Growth in revenues along with stable EBITDA margins and higher investment income is expected to result in increase in operating profitability over the rating horizon. Absence of sizeable one-off provisioning charges, as has been witnessed historically, given that no Voluntary Separation Scheme (VSS) is planned is expected to result in greater stability in earnings.

The ratings incorporate PTCL's strong balance sheet and abundant liquidity, elements that provide the company with financial flexibility and support its rating.

Liquidity position is strong, with significant cash resources available together with healthy cash flow generation. Barring 2017, cash flow generation has historically remained in excess of capital expenditure incurred. Assessment of PTCL's liquidity profile also incorporates favorable working capital cycle where consistent cash collection has resulted in no utilization of short-term borrowings and accumulation of liquidity buffer on balance sheet. Liquid assets represent around one-tenth of the total asset base and around two-third of total group liabilities (primarily UFONE). Despite sizeable capital investments over the last two years, financial profile has remained comfortable with no debt on balance sheet. Capital investments are expected to remain elevated for 2018 and 2019 and are expected to witness a decline as PTCL nears completion of its NTP. Over the long-term, JCR-VIS expects PTCL to maintain good liquidity while investing adequate levels of capex to strengthen its competitive capacity.

Funds generated from operations and liquid investments carried on balance sheet are planned to be utilized to fund capex and other funding requirements. Barring equity injection in U Bank in 1QCY18, funding requirement of subsidiaries has been primarily catered through subordinated loans. Given that yield on these investments/loans is higher vis-à-vis average return on PTCL's investments and in the backdrop of increasing interest rates, overall return on investments is going to be favorably impacted.

Sound Corporate Governance Framework

In accordance with the provisions of Share Purchase Agreement between GoP and EIP as well as under the Articles of Associations of PTCL, the GoP has four nominees while EIP has five nominees on the board. Management team comprises qualified personnel and is supported by a well-designed organization structure which has been made significantly leaner through 3 VSSs undertaken during the decade. PTCL has implemented a SAP based Enterprise Resource Planning system. Detailed and timely annual report disclosures bode well from a transparency perspective and provide important information to stakeholders.

Pakistan Telecommunication Company Limited Appendix I

FINANCIAL SUMMARY (Unconsolidated) *(amounts in PKR millions)*					
BALANCE SHEET	**2014**	**2015**	**2016**	**2017**	**1H2018***
Fixed Assets	94,452	94,912	94,779	98,251	95,747
Trade Debts	15,759	14,304	14,228	16,040	16,712
Income Tax Recoverable	16,366	18,179	14,261	15,263	14,775
Short Term Investments	18,441	26,039	24,000	5,608	15,799
Cash & Bank Balances	4,519	2,210	5,902	14,243	3,238
Total Assets	179,574	180,378	182,637	186,158	191,433
Trade and Other Payables	44,345	46,814	59,143	62,003	63,048
Long Term Debt	-	-	-	-	-
Short Term Debt	-	-	-	-	-
Total Debt	-	-	-	-	-
Total Equity	92,144	86,218	83,013	84,952	88,792
INCOME STATEMENT					
Revenue	81,513	75,752	71,420	69,757	35,358
Gross Profit	25,830	21,968	21,062	18,714	9,836
Operating Profit	12,682	8,672	9,162	7,149	4,190
Adjusted EBITDA	29,882	26,603	26,145	24,204	11,926
Profit After Tax	5,207	8,760	6,835	8,350	3,690
RATIO ANALYSIS					
Gross Margin (%)	32%	29%	29%	27%	28%
Adjusted EBITDA Margin (%)	37%	35%	37%	35%	34%
Net Margin	6%	12%	10%	12%	10%
Trade debts/Sales	19%	19%	20%	23%	24%
FFO	9,217	20,648	18,970	17,189	12,617
FFO to Total Debt (%)	NA	NA	NA	NA	NA
FFO to Long Term Debt (%)	NA	NA	NA	NA	NA
Current Ratio (x)	1.57	1.55	1.27	1.13	1.18
Debt Servicing Coverage Ratio (x)	NA	NA	NA	NA	NA
Gearing (x)	-	-	-	-	-
Leverage (x)	0.95	1.09	1.20	1.19	1.16
ROAA (%)	3%	5%	4%	5%	4%
ROAE (%)	6%	10%	8%	10%	8%

** Ratios Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Pakistan Telecommunication Company Limited
Sector	Telecommunication Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see below
Instrument Structure	N/A
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
October 11, 2018	AAA	A-1+	Stable	Initial