RATING REPORT

Pakistan Telecommunication Company Limited

REPORT DATE:
October 16, 2019

RATING ANALYSTS:
Syed Fahim Haider Shah
fahim.haider@vis.com.pk

Maimoon Rasheed
maimoon@vis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	AAA	A-1+	AAA	A-1+
Rating Date	*October 11, 2019*		*October 11, 2018*	
Rating Outlook	Stable		Stable	
Rating Action	Initial		Initial	

COMPANY INFORMATION

Incorporated in 1995	**External auditors:** KPMG Taseer & Hadi Co., Chartered Accountants.
Public Listed Company	
	Chief Executive Officer: Rashid Naseer Khan **Board of Directors:** - Shoaib Ahmad Siddiqui - Abdulrahim A. Al Nooryani - Naveed Kamran Baloch - Rizwan Malik - Hatem Dowidar - Syed Shabahat Ali Shah - Serkan Okandan - Hesham Al Qassim - Khalifa Al Shamsi

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Pakistan Telecommunication Company Limited

OVERVIEW OF THE INSTITUTION

Pakistan Telecommunication Company Limited (PTCL) was incorporated in 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 the 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.

RATING RATIONALE

Pakistan Telecommunication Company Limited (PTCL) is the leading Integrated Information Communication Technology (ICT) Company in Pakistan, having the largest fixed-line network in the country. The company's products and services include voice services, high-speed broadband internet, CharJi wireless internet, Smart TV (IPTV) service, , Smart TV App and Touch App, digital-content streaming services like Netflix, and icflix, and enterprise-grade platforms like Smart Cloud, Tier-3 Certified Data Centers, Managed and Satellite Services.

The assigned ratings take into account strong ownership structure of PTCL, as 62.2% shareholding is held by the Government of Pakistan (GoP) and 26% by Etisalat Group along with the management control. Etisalat Group currently carries AA-/Stable ratings from the S&P Global and Aa3/Stable ratings from Moody's. The ratings draw comfort from PTCL's leading market position in fixed-line voice segment with 90% share, wireline broadband segment with 80% share, and wireless data segment with 30% share. While the company's voice and wireless data segments are expected to remain under pressure due to continued shift towards mobile data and strong competition from Cellular Mobile Operators (CMOs), the strengthening of infrastructure with the completion of Network Transformation Project (NTP) will underpin growth in broadband and IPTV business. The ratings also factor low financial risk profile of the company, as reflecting in healthy cash flows generation and debt-free balance sheet despite significant capital expenditure over the past three years.

Sector Overview

Total telecom revenues stood at Rs 488.8b during FY18 and have reached around a revenue of Rs. 268.8b during 1HFY19. The latest available data shows that total cellular, including 3G/4G, and broadband subscribers have reached 162m and 73m with teledensity and penetration levels of 76.8% and 34.8%, respectively. Meanwhile, basic telephony subscriber base has contracted to 2.7m with teledensity of just 1.3%. The market is dominated by 4 CMOs, accounting for nearly 78% of total telecom revenues. The remaining 22% revenue is generated through Local Loop, Long Distance International (LDI), Wireless Local Loop (WLL) and Value-Added Services (VAS).

Data services remained the primary growth driver while the voice segment remained stagnant, particularly because of subscribers' shift to OTT and grey trafficking. Revenue growth for CMOs will continue to emanate from growing mobile data usage, spurred by increasing smartphone adoption and 3G/4G penetration. However, amidst strong competition for higher market share, the CMOs may continue to face pricing challenge, as reflected by low monthly average revenue per user (ARPU) which currently stands at around $1.6 in Pakistan, compared to $11.9 in Asia-Pacific and $8.5 globally. Going forward, 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.

With only 5% household subscribers, wireline broadband penetration in Pakistan is much lower than the global standards. High price elasticity and expanding demand for data means wireline broadband subscriber base can witness significant growth, going forward. However, strengthening network infrastructure by removing impediments, particularly right of way permissions, is considered important.

Stabilizing top-line underpinned by sustained growth in broadband & IPTV business while gross margins continue to contract

PTCL has divided its operations into six segments; broadband & IPTV is the largest segment and accounts for 38% of total revenue, followed by voice service 20%, international 14%, carrier and wholesale 13%, corporate 10% and wireless data 4%.

PTCL has made encouraging progress towards stabilizing its top-line. After continued decline between 2014 and 2017, the company's revenue increased marginally to Rs. 70.1b during 2018 (2017: Rs. 69.6b; 2016: Rs. 71.4b), as the impact of further decrease in voice service and wireless data segments was more than offset by sustained growth in broadband & IPTV, corporate segment, and international segments. Total revenue amounted to Rs. 35.8b during 1H2019.

PTCL reported Rs. 17.8b in gross profit during 2018 (2017: Rs. 18.6b; 2016: Rs. 21.1b) as the impact of marginally higher revenue was more than offset by higher cost of services, resulting in lower gross margin of 25.5% (2017: 26.7%; 2016: 29.5%). Gross margin has contracted to 25.2% during 1H2019 mainly due to rupee devaluation i.e. 26% for 2018 and 17% for 1H2019, as costs associated with the foreign operator, cable & satellite, customer premises equipment, and network O&M etc. are USD denominated and were impacted by rupee devaluation. Gross margins were also impacted by higher salaries, allowances & benefits and outsourced staff costs due to inflationary adjustment, while the average number of employees remained largely stable.

Administrative and general expenses decreased marginally to Rs. 8.5b during 2018 (2017: Rs. 8.6b; 2016: Rs. 8.8b) mainly on account of notably lower legal & professional charges and reduced contribution to R&D and USF, partially offset by higher salaries expense and provision for doubtful debts. Meanwhile, selling and marketing expenses were recorded at Rs. 2.9b during 2018 (2017: Rs. 2.8b; 2016: Rs. 3.1b) on account of some increase in salaries and sales and distribution charge. PTCL reported operating profit of Rs. 6.5b during 2018 (2017: Rs. 7.2b; 2016: Rs. 9.2b) with lower operating margin of 9.3% (2017: 10.3%; 2016: 12.8%). Operating profit amounted to Rs. 3.4b during 1H2019 with largely stable margin of 9.4%.

PTCL also booked other income of Rs. 4.8b during 2018 (2017: Rs. 6.0b; 2016: Rs. 5.8b) on account of lower return on bank deposits as cash resources were utilized to fund capex, reduction in written-back liabilities and government grants, partially offset by higher interest income on long-term loan to subsidiaries as well as recognition of gain on mutual funds and dividend income from U Microfinance Bank Limited (Ubank). Other income amounted to Rs. 2.3b during 1H2019. Accounting for taxation, the company reported net profit of Rs. 7.4b during 2018 (2017: Rs. 8.4b; 2016: Rs. 6.8b) with lower net margin of 10.6% (2017: 12.0%; 2016: 9.6%). Net profit amounted to Rs. 3.8b during 1H2019 with largely stable net margin.

Steady shift in asset mix due to sizeable investment in long-term infrastructure assets
Total assets of the company stood to Rs. 199.8b at end-1H2019 (2018: Rs. 196b; 2017: Rs. 187.3b), with fixed assets representing 66% (2018: 65%; 2017: 62%) of overall assets and current assets 34% (2018: 35%; 2017: 38%). Property, plant and equipment increased to Rs. 108.7b (2018: Rs. 106.2b; 2017: Rs. 100.5b), while capex amounted to Rs. 9.5b (2018: Rs. 19.9b; 2017: Rs. 18.5b) that mainly pertained to transformation and upgradation of infrastructure under NTP. The company also recorded Rs. 1.3b (2018: nil) in right of use assets which represented capitalization of all operating rentals under IFRS 16 'Leases'. Intangible assets, representing Telecom license, WLL Spectrum, WLL & LDI License, and IPTV, amounted to Rs. 1.4b at end-1H2019. Long-term investments in subsidiaries and associates remained unchanged at Rs. 9b (2018: Rs. 9b; 2017: Rs. 8b), whereas long-term loans & advances increased slightly to Rs. 10.9b (2018: Rs. 10.7b; 2017: 5.4b) due to increase in loans to employees while loans to subsidiaries remained unchanged during the period.

Store, spares, and loose tools amounted to Rs. 4.7b at end-1H2019 (2018: Rs. 6.1b; 2017: Rs. 3.6b). The increase during 2018 was due to higher procurements related to NTP. Trade debts and contract assets – net of allowance for expected credit loss increased to Rs. 19.9b by end-1H2019 (2018: Rs. 16.2b; 2017: Rs. 16b) partially due to accumulation of foreign receivables and rupee deprecation. Income tax recoverable amounted to Rs. 15.5b (2018: Rs. 16.5b; 2017: Rs. 15.3b), while prepayments and other receivables increased to Rs. 16.1b (2018: Rs. 14.1b; 2017: Rs. 11.9b) on account of higher amount due from the related parties.

Liquidity position supported by healthy cash flows generation, though cash resources have depleted significant to fund NTP
Liquidity profile of the company underpinned by healthy operating cash flows generation excluding working capital changes, and a conservative capital structure. The company generated higher funds from operations (FFO) of Rs. 24b during 2018 (2017: Rs. 16.7b; 2016: Rs. 19b) mainly on account of reduced contribution to Pakistan Telecommunication Employee Trust amounting to Rs. 2.8b (2017: Rs. 5.3b; 2016: 12b), absence of payment of voluntary separation scheme (2018: Nil: 2017: Rs. 4.7b), and consideration paid against purchase of PTML losses (2018: Nil; 2017: Rs. 2.2b) However, the current ratio decreased to 1.0x during 2018 (2017: 1.14x;

2016: 1.27x) on account of lower current assets due to utilization of cash and short-term investment for capex and increase in current liabilities.

FFO and current ratio were recorded at Rs. 13.6b and 1.0x, respectively, during 1H2019. Liquidity profile of the company also supported by favorable cash conversion cycle, where consistent cash collection from customers and favorable payment term with creditors leads to debt free balance sheet. Cash & bank balance amounted to Rs. 6.0b (2018: Rs. 10.3b; 2017: Rs. 16.8b) at end-1H2019, as the company has made significant capex in NTP over the last two and a half year.

PTCL continued to maintain debt-free balance sheet despite significant capital expenditure
Paid-up capital of the company remained unchanged at Rs. 51b at end-1H2019, while equity base stood at Rs. 84b (2018: Rs. 83.6b; 2017: Rs. 85.1b). Growth in equity was restrained by interim dividend payment of Rs. 2.6b during the period (2018: Rs. 5.0b; 2017: Rs. 5.1b). PTCL continued to maintain debt-free balance sheet during the period. Given reduction in liquid investments and cash resources, the management may consider mobilizing debt financing in future, if needed. Total liabilities increased to Rs. 115.8b by end-1H2019 (2018: Rs. 112.5b; 2017: Rs. 102.2b) mainly due to higher employee retirement benefit liability of Rs. 31.2b (2018: Rs. 28.5b; 2017: Rs. 23.5b) and addition of lease liability. Trade and other payables were recorded at Rs. 66.8b at end-1H2019 (2018: Rs. 67.2b; 2017: Rs. 61.6b). Resultantly, debt leverage indicators stood at 1.38x at end-1H2019 (2018: 1.35x; 2017: 1.20x).

PTCL accommodates funding requirements of its subsidiaries through a mix of debt and equity. During 2018, PTCL injected Rs. 1b in equity and Rs. 4b in subordinated long-term loan in its wholly owned subsidiary Ubank. The loan to Ubank is recoverable in 4 semi-annual installments, commencing after a grace period in 2024, and carries a markup rate of 3-month KIBOR plus 2%. PTCL also injected another Rs. 1b in subordinated to PTML during 2018 (2017: Rs. 5b; 2016: nil). The entire Rs. 6b loan to PTML is recoverable in 12 equal quarterly installments, commencing after a grace period in 2022. It carries a markup of 3-month KIBOR plus 0.24%.

Pakistan Telecommunication Company Limited **Annexure I**

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**CY16**	**CY17**	**CY18**	**1HCY19**
Fixed Assets	107,281	116,098	127,866	131,680
Trade Debts	14,228	16,040	16,179	19,850
Income Tax Recoverable	14,261	15,253	16,478	15,546
Prepayment and Other Receivable	11,328	11,861	14,128	16,069
Other Current Assets	5,636	8,245	11,088	10,626
Short-term Investment	24,000	5,608	4,930	245
Cash and Bank Balance	5,902	14,243	5,375	5,761
Total Assets	**182,637**	**187,348**	**196,044**	**199,776**
Trade and Other Payables	59,143	61,550	67,196	66,803
Employees Retirement Benefits	24,068	23,504	28,487	31,167
Deferred Govt. Grants	8,595	8,060	7,842	7,633
Deferred Income Tax	7,265	7,145	6,991	6,546
Other Liabilities	553	1,988	1,956	2,424
Short-term Debt	-	-	-	-
Long-term Debt	-	-	-	-
Lease Liability (including current maturity)	-	-	-	1,232
Total Liabilities	99,623	102,247	112,472	115,805
Tier-1 and Total Equity	**83,013**	**85,102**	**83,571**	**83,971**
INCOME STATEMENT	**CY16**	**CY17**	**CY18**	**1HCY19**
Revenue	71,420	69,620	70,100	35,772
Gross Profit	21,062	18,601	17,842	9,027
Operating Profit	9,162	7,177	6,514	3,374
Profit After Tax	6,835	8,368	7,422	3,792
FFO	18,970	16,671	23,959	13,562
RATIO ANALYSIS	**CY16**	**CY17**	**CY18**	**1HCY19**
Gross Margin (%)	29.5	26.7	25.5	25.2
Net Working Capital	16,213	8,936	139	318
FFO to Long-Term Debt (x)	-	-	-	-
FFO to Total Debt (x)	-	-	-	-
Debt Servicing Coverage Ratio (x)	-	-	-	-
ROAA (%)	4.0	4.5	3.9	3.8*
ROAE (%)	8.0	10.0	8.8	9.1*
Gearing (x)	-	-	-	-
Debt Leverage (x)	1.20	1.20	1.35	1.38
Current Ratio	1.27	1.14	1.00	1.00

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
October 11, 2019	AAA	A-1+	Stable	Initial
October 11, 2018	AAA	A-1+	Stable	Initial

Statement by the Rating Team	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	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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