

RATING REPORT

Pakistan Telecommunication Company Limited

REPORT DATE:

October 05, 2020

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AAA	A-1+	AAA	A-1+
Rating Date	October 05, 2020		October 11, 2019	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirm		Reaffirm	

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:

- Mr. Shoaib Ahmad Siddiqui
- Mr. Abdulrahim A. Al Nooryani
- Mr. Rizwan Malik
- Mr. Hatem Dowidar
- Mr. Hesham Al Qassim
- Mr. Khalifa Al Shamsi
- Mr. Naveed Kamran Baloch
- Syed Shabahat Ali Shah
- Dr. Mohamed Karim Bennis

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)

<https://www.vis.com.pk/ke-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, Fiber to the Home (FTTH) services, Charji wireless internet, Smart TV (IPTV) service, Smart TV App and Touch App, digital-content streaming services like Netflix, and enterprise-grade platforms like Smart Cloud, Tier-3 Certified Data Centers, Managed and Satellite Services.

Sector Dynamics

Telecom sector revenues grew by 12.9% and amounted to Rs. 552b in FY19. The main contributor to revenue remained the mobile sector with total revenues crossing Rs. 444b, followed by Fixed Local Loop (FLL) and Wireless Local Loop (WLL) services at Rs.69b. The sector received USD 236m FDI inflow during the year. The telecom sector is dominated by 4 Cellular Mobile Operators accounting for nearly four-fifth of the total telecom revenues. The remaining revenue is generated through Local Loop, Long Distance International (LDI), Wireless Local Loop (WLL) and Value-Added Services (VAS). The latest available data (July'2020) shows that total cellular, 3G/4G, and broadband subscribers have reached 167million, 81million and 83million, respectively. Teledensity and broadband penetration levels of 78.84%, and 39.25%, respectively are expected to increase going forward and will support revenue growth of telecom operators. Meanwhile, basic telephony subscriber base was recorded at 3million.

Data services remained the primary growth driver while revenues from the voice segment remained stagnant, particularly because of subscribers' shift to OTT platforms. Revenue growth for CMOs will continue to emanate from growing mobile data usage, spurred by increasing smartphone 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 \$1.96 in Pakistan, compared to \$3.94 in South Asia 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.

Pakistan's fixed line penetration lags behind regional peers given Public Switched Telephone Network (PSTN) and broadband penetrations are less than 8% and 6% of total households respectively. However, strengthening network infrastructure by removing impediments, particularly right of way permissions, is considered important. FTTH remains the key focus areas for telecom operators in the country to meet high speed data demand of the consumers.

Rating Drivers

Strong financial profile of sponsors is a key rating driver

The assigned ratings take into account strong ownership structure of PTCL, as 62.2% shareholding is held by the Government of Pakistan (GoP) while 26% ownership along with management control is held by Etisalat Group. Etisalat Group provides services to 149million subscribers globally and has expanded in 16 countries across the Middle East, Asia and Africa and is amongst the largest telecom operator in the world. The Group is rated AA- and Aa3 by S&P and Moody's, respectively.

Leading market position and integrated nature of operations

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, wire line broadband and wireless data segment.

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

- **Broadband and FTTH:** Low cyclical in sales and healthy demand outlook for Wireline broadband segment due to existing low penetration bodes well for revenue growth of the segment. With completion of the first phase of the network transformation plan (NTP), around 70% of the broadband customers have transitioned to speed of 4Mbps and above which will facilitate in better customer experience. FTTH revenues recorded an increase of 172% during 2019 with growth expected in new customer and revenues expected to continue in 2020. Overall ARPU for the segment has depicted improvement based on shifting of customers towards higher bandwidth packages.
- **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 VIS expects to continue. However, fixed line revenues from increasing broadband subscribers are expected to support revenues.
- **Wireless:** 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.
- **Corporate:** Segment has depicted healthy growth over the last 2 years where PTCL's diversified product offerings in the ICT segment (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. Growth has been particularly robust in revenues from cloud and data center services.
- **Wholesale & Carrier:** Growing demand for data is expected to bode well for revenues from the segment. Overall growth in carrier business was recorded at 15% in 2019 mainly driven by revenues from IP bandwidth segment which increased by 50%. Growth momentum has continued in the ongoing year.

Overall revenues have been maintained while margins witnessed a decline due inflationary increase in power and network cost. Focus on higher ARPU segments and value added services along with cost control initiatives is expected to facilitate in recovery of margin over the rating horizon

The company reported revenue of Rs. 71.5b (2018: Rs. 71.3b) during 2019 whereby broadband & IPTV and Corporate segments increased by 5% and 13%, respectively. Growth in corporate segment revenues is largely contributed by growth services including data, data center, and cloud services recording a surge of 9%, 25% and 117% in revenues, respectively during 2019. During the outgoing year PTCL won large contracts for data centers from two large banks of the country. The company also provides cyber security and cloud solutions to leading banks. Growth in wholesale and carrier business was mainly driven by growth in wholesale data business expanding the company's market leadership in the segment. Moreover, growth in VSAT (Very Small Aperture Terminal- a two-way ground station that transmits and receives data from satellites) has enabled PTCL to be the sole bandwidth provider for different cellular, LDI and local loop operators.

During 1H2020, the revenue base of the company witnessed a decline in the retail segment (major contributor being voice and DSL) which was off-set by growth in business services segment. This was primarily due to impact of COVID-19 whereby new subscriptions slowed down and temporary services suspension of certain existing clients impacted revenues. Carrier business witnessed healthy growth amidst the pandemic owing to higher data usage on cellphones during the period. The management envisages broad-based growth across all segments (except voice) for 2H2020.

Gross margin has contracted to 23.7% for 2019 and 20.7% for 1H2020 (2018: 24.9%), 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 power costs. PTCL reported operating profit of Rs. 4.9b during 2019 (2018: Rs. 6.5b), decline of which is attributable to subdued gross profitability and higher operating costs. Going forward, management projects EBITDA margins to recover due to focus on higher ARPU segments and value added services along with cost control initiatives.

PTCL also booked other income of Rs. 4.7b during 2019 (2018: Rs. 4.8b) which mainly include return on bank deposits, interest income on long-term loan to subsidiaries, written-back liabilities, government grants and gain on disposal of PPE. Accounting for taxation, the company reported net profit of Rs. 6.3b (2018: Rs. 7.4b) and Rs. 2.7b during 2019 and 1H2020, respectively.

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. Given limited capital expenditure plans going forward, free cash flow available with the company will be higher in the ongoing year which is expected to strengthen liquidity buffer. 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. Despite sizeable capital investments over the last three years, financial profile has remained comfortable with no debt on balance sheet. Capital investments have slowed down in the ongoing year with the completion of NTP. Over the long-term, VIS expects PTCL to maintain healthy 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. Funding requirement of subsidiaries has been primarily catered through subordinated loans. Going forward, management expects funding requirements to remain limited except in case of spectrum acquisition by Ufone.

Sound Corporate Governance Framework

In accordance with the provisions of Share Purchase Agreement between GoP and Etisalat Group as well as under the Articles of Associations of PTCL, the GoP has four nominees while Etisalat Group 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
Annexure I

FINANCIAL SUMMARY (Unconsolidated)							
	<i>(amounts in PKR millions)</i>						
BALANCE SHEET	2014	2015	2016	2017	2018	2019	1H2020
Fixed Assets	94,452	94,912	94,779	98,251	106,151	116,720	113,808
Trade Debts	15,759	14,304	14,228	16,040	16,658	20,259	22,283
Income Tax Recoverable	16,366	18,179	14,261	15,263	16,478	17,756	16,551
Short Term Investments	18,441	26,039	24,000	5,608	4,930	7	-
Cash & Bank Balances	4,519	2,210	5,902	14,243	4,661	4,168	7,053
Total Assets	179,574	180,378	182,637	186,158	196,523	209,994	214,214
Trade and Other Payables	44,345	46,814	59,143	62,003	67,675	78,262	80,243
Long Term Debt	-	-	-	-	-	-	-
Short Term Debt	-	-	-	-	-	-	-
Total Debt	-	-	-	-	-	-	-
Paid up Capital	51,000	51,000	51,000	51,000	51,000	51,000	51,000
Total Equity	92,144	86,218	83,013	84,952	83,571	87,751	87,904
INCOME STATEMENT							
Revenue	81,513	75,752	71,420	69,757	71,273	71,548	35,333
Gross Profit	25,830	21,968	21,062	18,714	17,742	16,979	7,319
Operating Profit	12,682	8,672	9,162	7,149	6,514	4,939	1,432
Adjusted EBITDA	29,882	26,603	26,145	24,204	26,519	26,611	13,374
Profit Before Tax	8,012	13,272	10,201	12,845	10,757	9,331	3,917
Profit After Tax	5,207	8,760	6,835	8,350	7,773	6,347	2,703
RATIO ANALYSIS							
Gross Margin (%)	32%	29%	29%	27%	25%	24%	21%
Adjusted EBITDA Margin (%)	37%	35%	37%	35%	37%	37%	38%
Net Margin	6%	12%	10%	12%	11%	9%	8%
Trade debts/Sales	19%	19%	20%	23%	23%	28%	63%
FFO	9,217	20,648	18,970	17,189	24,071	23,283	13,237
FFO to Total Debt (%)	NA	NA	NA	NA	NA	NA	NA
FFO to Long Term Debt (%)	NA	NA	NA	NA	NA	NA	NA
Current Ratio (x)	1.57	1.55	1.27	1.13	1.01	0.88	0.89
Debt Servicing Coverage Ratio (x)	NA	NA	NA	NA	NA	NA	NA
Gearing (x)	-	-	-	-	-	-	-
Leverage (x)	0.95	1.09	1.20	1.19	1.35	1.39	1.44
ROAA (%)	3%	5%	4%	5%	4%	3%	3%
ROAE (%)	6%	10%	8%	10%	9%	7%	6%

* Ratios 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
	<u>RATING TYPE: ENTITY</u>				
	October 5, 2020	AAA	A-1+	Stable	Reaffirmed
	October 11, 2019	AAA	A-1+	Stable	Reaffirmed
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.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted	Name	Designation		Date	
	Nadeem Khan	Chief Financial Officer		10-Sept-2020	
	Zarrar Hasham Khan	Chief Business Officer		10-Sept-2020	
	Sayyed Muhammad Imran Ali	EVP Digital Services		10-Sept-2020	
	Muhammad Amir Siddiqui	EVP Group Financial Planning & Treasury		10-Sept-2020	
	Muhammad Yar Anwar	GM Billing and BI Reporting		10-Sept-2020	
	Mudasser Shafiq	GM Budgeting, Planning & Control		10-Sept-2020	