RATING REPORT

Pakistan Telecommunication Company Limited (PTCL)

REPORT DATE:

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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 Outlook	*Stable*		*Stable*	
Rating Date	*Nov 07th 2023*		*Oct 20th, 2022*	
Rating Action	*Reaffirm*		*Reaffirm*	

COMPANY INFORMATION

Incorporated in 1995	**External auditors:** KPMG Taseer & Hadi Co., Chartered Accountants.
Public Listed Company	
Key Shareholders (with stake 5% or more): The Government of Pakistan (62%) Etisalat International Pakistan (26%)	**President & CEO:** Mr. Hatem Mohamed Bamatraf **Chairman:** Hassan Nisar Jamy **Board of Directors:** – Abdulrahim A. Al Nooryani – Khalid Murshed – Ms. Brooke Lindsay – Dr. Ahmed Mujtaba Memon – Dr. Mohamed Karim Bennis – Mr. Imad Ullah Bosal – Ahad Khan Cheema – Mikhail Gerchuk

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

VIS Issue/Issuer Rating Scale
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Pakistan Telecommunication Company Limited (PTCL)

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

Profile of Chairman

Hassan Nasir Jamy is an officer of Pakistan Administrative Service (PAS) with over 34 years of experience in a variety of core disciplines in the public sector. The officer has a diverse range of experience and exposure of the public sector at the Federal and provincial levels. Among other positions, he has worked as Federal Secretary of Water Resources Division, Privatization Division/Commission, Aviation Division and Climate Change Division. He has also served in the Petroleum and Water & Power Divisions as an Additional Secretary. He remained a member of Directing Staff at the National School of Public Policy for two years.

RATING RATIONALE

The assigned ratings reflect Pakistan Telecommunication Company Limited (PTCL's) strategic market position as the country's leading Integrated Information Communication Technology Company, having the largest fixed-line network and 71% market share. The ratings incorporate the issuer's strong sponsor profile, given that the GoP holds significant shareholding (62%) while Etisalat Group holds a 26% equity stake and management control. Having 46 years of operating experience, Etisalat is present in 16 countries and is one of the largest telecom operators in the world. The ratings also consider the financial soundness and management acumen of Etisalat Group; the Group is rated AA- and Aa3 by S&P and Moody's, respectively. The ratings are also underpinned by low business risk profile of the telecom sector owing to the non-cyclical nature of the industry, dependence of other operators on the infrastructure offered by the Company and low sensitivity to inflationary pressures on operations conducted. Moreover, business risk also factors in capital-intensive and highly regulated nature of the sector serving as natural high barrier to entry for new entrants. PTCL has wholly owned subsidiaries, including Pak Telecom Mobile Limited (UFONE), a mobile service provider, and a Microfinance Bank, U-Microfinance Bank Limited.

The ratings reflect the sound financial risk profile of the Company, marked by positive momentum in revenues, sizable margins and profitability indicators, adequate liquidity profile, and substantial debt-service coverages. Despite procurement of incremental long-term borrowings to support PTML, gearing remained manageable and well aligned with the assigned ratings. Given, PTCL plans to inject further equity into PTML during the ongoing year to fund capital expenditure, gearing indicators of the Company are expected to trend upwards. However, the magnitude of the increase is expected to be offset by positive trajectory of the PTCL's profitability metrics coupled with the ongoing asset monetization strategy adopted. The ratings will remain contingent upon retention and improvement in market share coupled with maintenance of capitalization and liquidity indicators going forward.

The rating incorporates leading market positioning of PTCL in Fixed-Line Voice and Wireline Broadband & IPTV and Revenue Base Diversification

The Company's products and services include voice services, broadband internet, Fiber to the Home (FTTH) services, CharJi wireless internet, Smart TV (IPTV) service, Smart Link App and Touch App, digital-content streaming through Starzplay, and enterprise-grade platforms like Smart Cloud, Tier-3 Certified Data Centers, Managed and Satellite Services. Ratings draw support from PTCL's leading market position in Fixed-line Voice and Wireline Broadband & IPTV. Given PTCL has embarked on a journey to migrate their existing customers to the premium Fiber to the Home (FTTH) services; the Company has successfully expanded its fiber footprint to 60,000km becoming country's second largest FTTH operator. The segment resulted in a revenue growth of 102.7% and constituted 56% share of the industry's net adds. In addition, the broadband & IPTV subscribers base, the largest revenue generator, increased slightly on a timeline to 1.88m (CY22 1.86m; CY21: 1.78m) by end-CY23. The number of retail subscribers remained unchanged at 4.23m (CY22: 4.24m; CY21: 4.23m) during the rating review period at end-1HCY23. The Company is focusing on the wholesale and corporate business segment to fuel growth in the future.

Industry Overview

Profile of CEO

Hatem Bamatraf occupies the position of President & Group Chief Executive Officer at PTCL And PTML Telecommunication Co. Ltd.) and President & Group CEO-PTCL & Ufone at Emirates Telecommunications Group Co. PJSC. He previously was Executive Director-Technology at Etihad Etisalat Co., Chairman for Etisalat Technology Services LLC, and Chief Technology Officer at Emirates telecommunications Group Co. PJSC and Executive Vice President-Enterprise at Emirates Integrated Telecommunications Co. PSJC. He received an undergraduate degree from Etisalat University College.

International Telecommunication Overview

The global telecommunication service industry is expected to grow at a CAGR of 6.13% between 2023 and 2027 to USD 625.5 Billion. The expectation is attributed to the growing demand of internet, surge in global mobile data traffic and rapid increase in global population by 0.88% per year, which automatically boosts the market for the aforementioned services. Furthermore, the uptick in the broadband market is underpinned by increased reliance on telecommunication services for working and educational purposes. In businesses, automation and artificial tools such as automated chat boxes are being utilized to enhance customer experiences. In addition, employee management softwares like SAP are gaining popularity; these initiatives require telecom services, in turn contributing to the growth. Additionally, data suggests that digitization tools like online collaboration mechanisms boost productivity by around 30%, thus motivating managers to deploy internet services to achieve their productivity goals. Lastly, consumers continuously expect innovations and improvements over the current offerings, which puts pressure on the industry players to innovate promptly.

Domestic Outlook

Amid increasing fuel costs and as an aftereffect of the pandemic, digital communication popularity is on the rise. Offices are increasingly incorporating digitization to boost productivity and curtail operating expenses. With a CAGR of 3.28% expected for 2023-2028, the market size is projected to increase from USD 4.38 billion in 2023 to USD 5.15 billion in 2028. Moreover, as per data findings, mobile tele density in the country stood at 84.6% (191 million) during 2022 as opposed 81.73% in the previous year; the data encapsulates the 1.11% acquired by the fixed local loop (FLL) and wireless local loop (WLL). Annual broadband (BB) penetration (Mobile and Fixed) demonstrated a boost from 44.93% (102.7 mil) in 2021 to 50.96% (118.76 mil) in the year 2022. Amongst these numbers, mobile BB holds the most significant proportion of subscribers. Furthermore, average monthly revenue per user (ARPU) and total revenue per year also increased to Rs. 220 (CY21: Rs. 215) and Rs. 694.0b (CY21: Rs. 651.1b) respectively in CY22. The statistics indicate the growing demand for telecom services, establishing the inelasticity of demand; therefore, conclusively VIS believes that the telecom sector would not be affected by cyclicality risks.

Twofold competition is present in this sector. Firstly, there is competition among operators in the provision of home-based broadband services in which PTCL is the oldest provider. However, some emerging players catering to fiber broadband services are gaining popularity in recent years. These new operators (except few) rely on the submarine cables of PTCL for connectivity; thus, PTCL has an overall strategic position as the dominant provider with 71% of the current customer base. Secondly, given few players in the market, the cellular service market falls under oligopolistic competition domain with almost zero product/service differentiation. Subsequently, brand loyalty and customer satisfaction are most desirable parameters for the suppliers to maintain growth trajectory. Risk of obsolesce is also on the lower side due to slow paced development of telecom industry in Pakistan.

PTCL had a capital intensity ratio of 3.63 during 1CY23 implying significant investment in assets to generate revenue. Given the Company is the major provider of broadband and internet services within the country, sizable capex is required to ensure smooth operations. Furthermore, capital expenditure is imperative to keep abreast with the changing technology, such as the introduction of fiber to the home service. Hence, the significant capex requirements make entry of new participants difficult resulting in high barriers to entry. On the regulatory front, telecom is a heavily taxed sector including

34.5% tax for internet usage (15% withholding tax & 19.5% GST) on the consumer side, coupled with 29% corporate income tax and 4% super tax imposed last year. The aforementioned tax regime notably reduces the net income generated, thus making entry unattractive for new entrants.

Key Rating Drivers

Ratings incorporate stability in profit margins despite deteriorating economic conditions:

Uptick in the revenues with sustained margins during the outgoing year

The Company's topline registered a growth of 8.6% and was recorded at Rs. 83.4b (CY21: Rs. 76.8b) during CY22. The revenue mix comprises sales from broadband and IPTV services constituting 42% of the total revenue mix. The segment demonstrated positive growth momentum rate of 12% propelled by the aggressive FTTH expansion and was recorded at Rs. 35.2b (CY21: Rs 31.4b) during the outgoing year; the same in turn was a function of higher demand of broadband services for communication, e-learning, and working from home. The recent boom in freelancer market to 3 million during CY22 with heavy reliance on broadband services in Pakistan has positively reflected in the revenues. Moreover, E-learning also acquired popularity in this post-COVID era, fueling the growing demand.

Apart from FTTH, the business services segment continued its momentum by sustaining market leadership in IP Bandwidth, Cloud, Data Centers, and other ICT services segments. PTCL's Enterprise business grew by 18.8% compared to last year; this segment successfully secured key strategic ICT cloud projects along with core connectivity in the public and private sectors. Simultaneously, Carrier and Wholesale business also achieved growth of 34% during CY22, owing to the dependence of other operators on the infrastructure and connectivity offered by PTCL. The Company has deployed an international submarine cable network comprising four diverse routes, i.e., AAE1, SMW4, IMEWE, and SMW3, and one new sea cable in progress (Africa-1); hence, it is well positioned to serve the ever-growing data needs of the country. Moreover, PTCL is partner of choice for the carrier industry due to its nationwide optic fiber reach with multiple redundant links and a resilient core network, metro, and access network backed by Tier-3 certified data centers, managed facilities, and VSAT backhaul solutions.

The Company's gross margins remained intact at 21.9% (CY21: 21.5%) during CY22, owing to growth in customer base leading to better absorption of fixed cost components of cost of sales particularly employee related cost and foreign operators & satellite expenses. The same increase was witnessed in operating margins to 5.8% (CY21 5.4%) as the increase in operating expenses was in sync with growth in scale of operations. A practical application of cost management strategies is evident from these margin ratios. Moreover, sizable uptick was witnessed in income from other sources to Rs 10.8b (CY21: Rs. 5.8b) on account of notable exchange gain reaped amounting to Rs. 3.2b (FY21: Rs. 1.0b), gain on disposal of assets of Rs. 2.6b (CY21: Rs. 928.0m) and higher interest payments from subsidiaries recorded at Rs. 1.5b (CY21: Rs. 804.6m) in line with surge in the benchmark rates during the outgoing year. On the other hand, the finance cost increased significantly to Rs. 2.2b (CY21: Rs. 339.4m) as a combined outcome of procurement of Rs. 22.5b long-term debt for equity injection/subordinated debt into Pak Telecom Mobile Limited (PTML) coupled with an increase in benchmark rates. Nevertheless, PTCL reported sound bottom line with Rs 9.1b (CY21: Rs 6.9b), the highest since 2013, during CY22 despite the challenging economic conditions created as a result of inflation, devaluation of PKR against USD, hike in power tariffs, and other factors.

Ongoing year Profitability

The upward trajectory in revenues continued during the ongoing year as well with the topline recorded at Rs. 46.9b during 1HCY23; the same is 17.3% higher than the corresponding period last year (CPLY) mainly driven by growth in Carrier & Wholesale and Broadband segments. The Company further strengthened its flag ship FTTH brand, 'Flash Fiber' by achieving significant net subscriber additions by improving customer experiences and expansion of fiber network across the country; the FTTH revenue grew by 106.5% during the ongoing year. IPTV segment also showed a 5.8% revenue growth YoY. Voice and wireless revenue streams continued with declining trajectory as they are impacted by OTT services and tough competition from other cellular operators. Further gross margin remained significant at 22.0% for 1HCY23 owing to effective cost management, and stable demand patterns. Further, the net profit after tax improved by 34.5% to Rs. 6.9b as opposed to Rs. 5.2b in the CPLY due to translation gain on the Company's forex denominated receivables and gain on disposal of obsolete assets due to upgrade and fiberization of the network.

Liquidity Generation is Sound with a Positive Trajectory of Funds from Operations (FFO)

PTCL's liquidity generation has improved in line with the enhanced profitability metrics; the company generated higher adjusted funds from operations (FFO) in CY22 and onwards to the tune of Rs. 14.8b (CY22: Rs. 26.7b; CY21: Rs. 25.6b) during 1HCY23. However, owing to sizable procurement of long-term debt for equity injection in PTML coupled with higher utilization of short-term borrowings during the review period, the FFO to total debt and FFO to long-term debt declined on a timeline; however, the same remain comfortable. In addition, debt service coverage is strong and exhibits that the Company is comfortably placed in meeting the liquidity obligations falling due during the rating horizon.

Leverage Indicators

The Company's tier-1 equity augmented on account of internal capital generation. On the debt front, prior to CY22, PTCL had an almost negligible gearing ratio owing to no major debt procurement; however, in line with the mobilization of long-term debt of Rs. 22.5b and Rs. 18.0b in CY22 and HCY23 respectively, timeline increase in gearing and leverage is observed to 0.44x (CY22: 0.22x; CY21: 0.02x) and 1.95x (CY22: 1.82x; CY21: 1.47x) respectively by end-HY23. Apart from long-term borrowings, short-term credit worth Rs. 8.9b (CY22: Rs. 92m) was also utilized during the review period to meet working capital requirements. PTCL extended subordinated debt facility of Rs. 11.5b in July-22 and Rs. 4.5b in January'23 to PTML for prepayment of 4G spectrum license. Moreover, PTCL's Board has approved another equity injection to the tune of Rs.18.5b in PTML till end-CY23; out of the aforementioned, Rs. 13.0b has already been injected for payment of Capex.

Asset monetization plan is in place to improve cash inflow

PTCL is working on an asset monetization strategy whereby 12 commercial properties are planned to be sold and expected to bring sizable cash inflow over the next three years. Moreover, few other properties are also being considered for monetization in the long-term.

Sound Corporate Governance Framework

- In accordance with the provisions of Share Purchase Agreement between Government of Pakistan (GOP) and Etisalat Group as well as under the Articles of Associations of PTCL, the GOP has four nominees while strategic investor, Etisalat Group, has five nominees on the Board. All members are non-executive directors.
- A formal and effective mechanism is put in place for an annual evaluation of the Board's own performance and of its committees.
- Management team comprises qualified personnel and is supported by a well-designed organizational structure which has been made significantly leaner through 3 Voluntary Separation Schemes 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.

Medium Term and Short-Term Instruments

Currently, the management is undergoing negotiations for two Sukuk offerings. PTCL had planned to issue medium-term, rated, secured Sukuk (DSLR Listed) to eligible investors amounting to Rs. 5.0b inclusive of a Green Shoe Option of Rs. 1.0b. The issue amount was to be utilized by PTCL for its own CAPEX requirement in medium-term to long-term and equity/subordinated loan injection in Ufone. However, the management plans to first issue the unsecured short-term sukuk (STS) of Rs. 5.0b to meet working capital requirements.

Pakistan Telecommunication Company Limited Annexure I

FINANCIAL SUMMARY (Unconsolidated)	*(amounts in PKR millions)*			
BALANCE SHEET	**2020**	**2021**	**2022**	**1H23**
Property, plant and equipment	114,666	121,508	131,490	133,509
Trade Debts	23,150	27,937	39,293	48,611
Long Term Investments	17,736	30,736	44,736	60,236
Income Tax Recoverable	18,373	18,548	21,138	17,475
Cash & Bank Balances	5,764	2,556	5,685	7,589
Total Assets	223,600	245,735	305,160	340,379
Trade and Other Payables	88,457	103,320	124,933	124,924
Long Term Debt (Inc. Lease Liab.)	1,409	1,729	24,067	41,876
Short Term Debt	-	-	93	8,926
Total Debt	1,409	1,729	24,160	50,802
Total Liabilities	129,590	146,082	197,106	225,343
Paid up Capital	51,000	51,000	51,000	51,000
Tier I Equity	94,010	99,653	108,054	115,036
INCOME STATEMENT				
Revenue	71,804	76,853	83,444	46,920
Gross Profit	14,997	16,533	18,233	10,318
Operating Profit	3,447	4,168	4,881	2,969
Profit Before tax	8,493	9,682	13,513	11,165
Profit After Tax	6,030	6,874	9,053	6,982
FFO	23,109	25,560	26,683	14,816
RATIO ANALYSIS				
Gross Margin (%)	20.9%	21.5%	21.9%	22.0%
Net Margin	8.4%	8.9%	10.8%	14.9%
Trade debts/Sales	32.2%	36.4%	47.1%	51.8%
FFO to Total Debt (%)	16.40	14.78	1.10	0.58
FFO to Long Term Debt (%)	16.40	14.78	1.11	0.71
Current Ratio (x)	0.86	0.76	0.85	0.90
Debt Servicing Coverage Ratio (x)	71.58	57.80	45.63	10.15
Gearing (x)	0.01	0.02	0.22	0.44
Leverage (x)	1.38	1.47	1.82	1.96
ROAA (%)	2.78%	2.93%	3.29%	4.33%
ROAE (%)	6.64%	7.10%	8.72%	12.52%

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Pakistan Telecommunication Company Limited
Sector	Telecommunication Industry
Type of Relationship	Solicited
Purpose of Rating	Entity and Instrument Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
Nov 07, 2023	AAA	A-1+	Stable	Reaffirm
Oct 20, 2022	AAA	A-1+	Stable	Reaffirm
Oct 14, 2021	AAA	A-1+	Stable	Reaffirm

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: INSTRUMENT			
May 08, 2023	AAA	Stable	Preliminary

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.

Due Diligence Meetings Conducted

Name	Designation	Date
Shahid Mehmood	Manager	7th Sept, 2023, Thursday
Asif Imtiaz	Manager	
Iram Sayed	Manager External Funding	

Instrument
Secured medium term Sukuk amounting to Rs. 5.0b, having tenor of up to 6 years is assigned a preliminary rating of AAA.