RATING REPORT

Engro Enfrashare (Private) Limited

REPORT DATE:
September 08, 2023

RATING ANALYSTS:

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RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	Sep 08, 2023		May 06, 2022	

COMPANY INFORMATION	
Incorporated in 2018	**External auditors:** A.F. Ferguson & Co. (a member firm of Pricewaterhouse Coopers)
Private Limited Company	**Chairman of the Board:** Mr. Ghias Khan
Key Shareholders (with stake 5% or more):	**Country Managing Director:** Mr. Faisal Sattar (CEO)
Engro Connect (Private) Limited (100%)	
Engro Corporation Limited	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: ***Corporates (May 2023): https://docs.vis.com.pk/docs/CorporateMethodology.pdf*** ***Rating Scale & Definitions https://docs.vis.com.pk/docs/VISRatingScales.pdf***

Engro Enfrashare (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

In 2018, Engro Enfrashare (Private) Limited was incorporated as a private limited company. Enfrashare is a tower company (TowerCo) engaged in buying, building, maintaining, and operating telecommunication infrastructure, and related products and services. The Company holds Telecommunication Tower Provider (TTP) license granted by Pakistan Telecommunication Authority (PTA). The registered office of the company is situated in Islamabad.

RATING RATIONALE

The ratings assigned to Engro Enfrashare (Private) Limited (Enfrashare or the Company) take into account TowerCo industry's low business risk involving extensive lock-in periods, limited scope for termination and an escalation clause in built in the Service Agreement. The ratings also reflect the Company's retained dominant market positioning. In addition, the industry's demand outlook is positive stemming from rising demand of towers in turn being driven by growing mobile data usage, higher population density and increased technology dependence, the same paves way for improved coverage and capacity expansion. Tenancy ratio is a key growth driver in TowerCo business, which remains on the lower side in Pakistan and is indicative of room for growth. Further, the ratings are underpinned by strong sponsor profile of Enfrashare, which is a wholly owned subsidiary of Engro Connect (Private) Limited. The ultimate parent company is Engro Corporation Limited (Engro), which is one of the largest domestic conglomerates engaged in diverse businesses including fertilizers, LNG, energy, food and chemical sectors. Given high capital expenditure requirements of TowerCo business model, Engro has invested Rs. 6.0b in Enfrashare during the review period and is committed to invest up to another Rs. 5.0b in the ongoing year. On the other hand, ratings are constrained by elevated financial risk profile as reflected by loss before taxation, negative FFO coverages and debt service being lower than 1.0x. Moreover, stemming from financing procured for capital projects undertaken, leverage indicators have increased during the rating review period and continue to be on a higher side. Further, given there are sizable capex plans for expansion in the pipeline, gearing is forecasted to slide upwards or at least remain at current levels in the medium term.

Corporate Profile:

Enfrashare is a wholly owned subsidiary of Engro Connect (Private) Limited, which is 100% owned by Engro Corporation. Established in November 2018, the Company is providing telecommunication infrastructure services to telecommunication companies (telcos) – Mobile Network Operators (MNOs) and Internet Service Providers (ISPs) – in exchange for rental fee. The Company has gradually emerged as industry leader in the Tower Company (TowerCo) industry in Pakistan. TowerCo's facilitate in unlocking full potential of towers through infrastructure sharing, optimizing operational costs, rationalizing capital expenditure by investing in telecom towers, monitoring their operations, and providing efficient energy solutions. This allows the telcos to focus on their core business activities. The Company's registered office is located at Islamabad while regional offices are located at Karachi, Lahore and Multan. 155 districts of Pakistan are covered by Enfrashare's tower coverage. All four MNOs – Jazz, Telenor, Zong and Ufone have lock-in agreements with Enfrashare. Moreover, the Company holds Telecommunication Tower Provider (TTP) license granted by Pakistan Telecommunication Authority (PTA) for the all four provinces, federal administered areas, Gilgit-Baltistan and Azad Jammu & Kashmir.

Business Models:

The TowerCo industry operates under two models, as follows:

- **Sale & Leaseback Model:** Pursuant to this approach, existing towers are bought, upgraded, and developed in accordance with requirements, and revenue is generated by renting out the towers. Average residual life of leases for towers is 10 years.
- **Built-To-Suit (BTS) Model.** The BTS business entails signing agreements with telecommunications companies to build, own, and maintain towers. Additionally, towers built under this strategy are leased to other telecoms who must pay a leasing price in exchange for tenancy agreements. The business provides space for the installation of radio equipment as well as the necessary passive infrastructure, such as fences, shelters, air conditioning, generators, and batteries. On the rented site, telcos place their antennae and active (wireless) equipment. The Company retains ownership of the passive infrastructure, but Mobile Network Operators (MNOs) are the exclusive owners of all active components, such as antennae and wireless technology.

Sector Brief:

The TowerCo industry started with the establishment of the first TowerCo in 2014. Market share of the industry is divided among 4 major companies namely Engro Enfrashare, Edocto Pakistan (Pvt) Ltd, Tawal Towers (acquired Awal Telcom during 2022) and Associated Technologies. As of end-CY22, the TTP licenses approved by the PTA have been secured by 17 companies nationwide. As at end-1Q23, there were approximately 42,000 towers installed in the country, of which approximately 6,000 are being managed by the TowerCo industry. The market share for TowerCo industry for 2022 (in terms of towers) in Pakistan is presented below.

Market share		
Company name	2021	2022
Engro Enfrashare	48%	52%
Edotco	43%	35%
Associated Technologies	8%	12%
Tawal	1%	1%

Demand outlook of the TowerCo industry is positive, anticipated to be fueled by a growth in data usage, localization of smartphone manufacturing and other government-level policy initiatives. The approximate tenancy ratio for Pakistan is 1.3x, which is significantly lower than the 2.2x average worldwide. The figure in question illustrates portfolio inefficiencies in towers deployment, which could be decreased by expanding tower sharing transactions.

Operational Update:

Enfrashare's annual growth in tower portfolio was recorded at 48.2% during CY22. According to the management, the Company surpassed its projected target tower portfolio for the outgoing year owing to its market leadership backed by strong sponsor support. The tower count stood at 3,644 (CY22: 3,329; CY21: 2,206) at end-2QCY23; the same is projected to reach 4,000 by the end-CY23. In addition, the management is projecting the total count to reach ~5,000 by end-CY24.

The geographic distribution of Enfrashare's tower sites is divided into three regions: North (18%), Central (51%), and South (31%). Out of the existing towers at end-Dec'22, 93% are on BTS model. Similarly, given most of the towers are located in rural areas, around 90% towers are ground-based. Energy is a major cost component, thus 46% of the existing tower portfolio is on renewable energy source (solar); the same mitigates the risks associated with increase in fuel prices and fuel supply chain hurdles. Tower operations accounted for 49.2% revenue share (CY22: 49.8%, CY21: 57.2%) while contribution from energy services was booked at 39.2% (CY22: 37.4%, CY21: 25.2%) during 1QCY23. The management expects that energy revenue will remain in line in present figures and continue to support the profitability profile going forward.

To manage profitability, pricing escalation clause mentions an increase every year in the Master Agreement and the land lease agreement signed with the parties involved; hence, Enfrashare reaps an adequate incremental positive spread with every passing year.

Despite uptick in revenues negative bottom line was reported owing to heavy reliance on borrowings in turn resulting in substantial financial expense:
The revenue exhibited exponential growth while doubling to Rs. 9.1b (CY21: 4.5b) during the outgoing year primarily owing to sizable passive infrastructure and operations and maintenance fee recorded; the same was a function of higher numbers of towers installed coupled with increase in tenancy ratio to 1.17x (CY21: 1.10x) during CY22. The Company managed to outpace the projected tenancy ratio 1.14x for the outgoing year. As per the management, the improvement in tenancy is underpinned by change in strategy of Telcos to focus entirely on their core operations rather than Capex initiations making more room for Enfrashare to operate as the market leader and provide Towerco services. In addition, there was significant increase recorded in energy revenue to 2.0b (CY21: Rs. 586.2m) during the outgoing year.

Under the long-term contract agreements, telcos order towers in bulks. The cost of each tower is around Rs.13m and it takes around 3 months (can vary based on location) to erect and make one fully operational. The MNOs decide the placement, proximity of new towers and tower sharing (tenancy) with other MNOs. Jazz contributes 38% of the revenue followed by Ufone with 30%. Jazz is expected to remain the leading contributor in line with its highest market share in the MNO sector, having longer residual value of towers and lengthier lock-in agreements (12 years compared to 10 years with other MNOs). The management is projecting to close CY23 at a total revenue of Rs. 17.0b (CY22: 10.6b); the same is realistic and achievable given the Company booked gross revenue of Rs. 3.5b in 1QCY23 as opposed to Rs. 1.8b in the corresponding quarter last year.

The gross margin declined slightly on a timeline to 40.1% (CY22: 42.1%; CY21: 46.5%) during 1QCY23 owing to sizable depreciation and amortization expense booked in line with significant capital expenditure incurred during the rating review period. However, despite the decline the gross margins are sound and are expected to be recorded around 50% in the medium term. The general and administrative expenses increased to Rs. 745.2m (CY21: Rs. 492.0m) on account of increase in scale of operations and general inflation. Nevertheless, despite significant uptick in revenues, Enfrashare reported negative bottom line primarily owing to considerable jump in financial expense to Rs. 4.0b (CY21: Rs. 2.1b) during CY22; the same was a combined outcome of increase in borrowings and policy rate hikes. The management had projected to close the outgoing year in green; however, due to 600bps benchmark rate increase the Company was unable to achieve it. Nevertheless, it is pertinent to mention that quantum of loss reduced greatly during the outgoing year in line with the upward trajectory of revenues evidenced. Moreover, with regressed profitability indicators reported during 1QCY23, the breakeven projection stands for CY24 with achievement of economies of scale after surpassing erection of ~5,000 towers and recording tenancies of over 6,150.

Liquidity & Coverage:

During the rating review period, the liquidity position has remained stressed as Funds from Operations (FFO) continued to be reported under negative territory. Given, FFO largely mimics the trend of profitability indicators, the same improved sizably during the outgoing year; however, could not turn positive owing to significant financial expense borne. Subsequently, the FFO coverages were also negative. Further, the Debt Service Coverage Ratio (DSCR) was recorded below 1.0x during the review period. The obligations were either serviced through procurement of additional long-term debt worth Rs. 10.0b or share capital subscription amounting to Rs. 4.3b during the outgoing year. Further, Enfrashare's current ratio has also scaled down to 0.89x (CY21: 1.70x) in line with short-term loan worth Rs. 2.5b procured from parent company coupled with increase in long-term borrowings to be paid within one year. Nevertheless, the liquidity position is supported by adequate cash balances amounting to Rs. 3.2b (CY22: Rs. 2.6b; CY21: Rs. 4.6b) carried on the books at end-1QCY23. Going forward, the effective working capital management will remain imperative for sustenance of ratings. Moreover, given the liquidity metrics are largely going to be a reflection of profitability indicators; any noticeable improvement is only expected post CY23.

Capitalization:

Engro Connect (Private) Limited holds 100% shareholding in Enfrashare; the paid-up capital augmented on a timeline to Rs. 17.5b (CY22: Rs. 15.8b; CY21: Rs. 11.5b) as the parent company acquired shares amounting to Rs. 4.3b and 1.7b issued by the Company during CY22 and 1QCY23 respectively. As a result, the Company's equity increased significantly during the review period despite sizable accumulated loss recorded at end-1QCY23. The assets are financed through a combination of both debt and equity with financial covenants requiring the Company to have an ideal debt-to-equity mix of 65:35.

The long-term financing including current portion increased significantly on a timeline to Rs. 24.1b (CY22: Rs. 24.1b; CY21: Rs. 13.8b) by end-1QCY23 on account of sizable capex aggregating to Rs. 20.8b carried out on operating and right of use assets during the rating review period. Lease liabilities pertain to right of use on tenanted sites, offices and software. In line with growth in tower sites in the previous financial year, lease liabilities also increased on a timeline by end-1QCY23. In addition to this, Enfrashare has also obtained an unsecured short-term facility from the Parent Company to the tune of Rs. 8.0b; the interest is locked in at 1M-KIBOR + 0.20% per annum and is payable on quarterly basis in arrears. The utilized amount was recorded a Rs. 3.0b (CY22: Rs. 2.5b; CY21: nil) at end-1QCY23; the tenor of the loan is one year from Oct'22 and can be settled by either party upon request without any penalty for early payment. Given the loan carries mark-up charge, has a maturity date and is also payable on demand it is taken under total outstanding borrowings of the Company.

The financial risk remains elevated as gearing increased on a timeline to 2.64x (CY22: 2.84x, CY21: 2.47x) by end-1QCY23 despite sizable equity injection owing to hefty procurement of borrowings during the review period. Heavy reliance of debt remains a limitation of the business model as significant capital expenditure has to be carried out for the installation of towers. Moreover, the payback period is on the lengthier side. However, the debt leverage largely remained unchanged on a timeline basis and was recorded at 3.10x (CY22: 3.38x, CY21: 3.07) at end-1QCY23 as there was slight decline in deferred liabilities. Capital expenditure worth Rs. 12.0b is planned to be incurred in the ongoing year on the erection of 700+ towers against which Enfrashare plans to procure incremental commercial funding to the tune of Rs. 7.0b. The remaining Rs. 5.0b is to be funded by equity injection therefore capitalization indicators are expected to either remain at current levels or slightly scale upwards during the rating horizon. The maintenance of capital structure within manageable limits will remain important from ratings perspective.

Engro Enfrashare (Private) Limited **Annexure I**

FINANCIAL SUMMARY				*(Amount in Millions)*
BALANCE SHEET	**2020**	**2021**	**2022**	**1Q23**
Property, Plant & Equipment	10,253	18,318	34,242	36,411
Right of use assets	4,171	7,519	10,675	10,720
Finance Lease Receivables (inc. current portion)	858	710	538	284
Trade Debts	628	1,219	2,389	2,443
Cash & Bank Balances	187	4,630	2,596	3,153
Other Assets	1,513	3,173	8,684	7,774
Total Assets	**17,611**	**35,569**	**58,725**	**60,786**
Long-Term Borrowings (inc. current matur.)	1,011	13,763	24,062	24,114
Finance from parent company - subordinated	9,489	-	-	-
Lease Liabilities	4,279	7,794	11,623	11,907
Trade & Other Payables	3,023	4,047	6,282	5,902
Short term finance from Parent Company	-	-	2,500	3,111
Other Liabilities	1,522	1,231	15,133	25,030
Total Liabilities	**19,325**	**26,835**	**45,433**	**45,950**
Issued, Subs, and Paid-Up Capital	450	11,475	15,815	17,505
Advances & Sponsors Contribution	326	326	326	326
Accumulated Profit/(Loss)	(2,490)	(3,066)	(2,675)	(2,996)
Total Equity	**(1,714)**	**8,734**	**13,466**	**14,835**
INCOME STATEMENT	**2020**	**2021**	**2022**	**1Q23**
Net Revenue	1,409	4,489	10,589	3,538
Gross Profit	315	2,088	3,831	1,209
Operating Profit	(236)	1,584	3,184	1,052
Profit/ (Loss) Before Tax	(1,245)	(520)	(788)	(421)
Profit/ (Loss) After Tax	**(1,299)**	**(669)**	**(253)**	**(537)**
FFO	(435)	(1,103)	(185)	(524)
RATIO ANALYSIS	**2020**	**2021**	**2022**	**1Q23**
Gross Margin	22.4%	46.5%	42.1%	40.1%
Net Margin	-92.2%	-14.9%	-2.8%	-17.8%
Current Ratio	0.63	1.70	0.89	0.76
FFO to Long-Term Debt	NA	NA	NA	NA
FFO to Total Debt	NA	NA	NA	NA
Debt Servicing Coverage Ratio (x)**	0.50	0.56	0.78	0.64
ROAA*	NA	NA	NA	NA
ROAE*	NA	NA	NA	NA
Gearing (x)	-8.62	2.47	2.84	2.64
Debt Leverage (x)	-11.30	3.07	3.38	3.10

**Annualized*

*** this includes interest on parent company loan*

REGULATORY DISCLOSURES — Annexure II

Name of Rated Entity	Engro Enfrashare (Private) Limited
Sector	Telecommunication
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
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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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
08-09-2023	A-	A-2	Stable	Reaffirm
06-05-2022	A-	A-2	Stable	Reaffirm
27-12-2020	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Farjad Ahmed	Manager – Group Financing	11 July, 2023