RATING REPORT

Tower Power (Private) Limited

REPORT DATE:
February 21, 2024

RATING ANALYSTS:

Maham Qasim
maham.qasim@vis.com.pk

Basel Ali Assad
basel.ali@vis.com.pk

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 Action	Reaffirmed		Initial	
Rating Date	*February 21, 2024*		*October 05, 2022*	

COMPANY INFORMATION

Incorporated in 2019	**External auditors:** Grant Thorton Anjum Rehman Chartered Accountants
Private Limited Company	**Chairman/CEO:** Mr. Mobashir A. Malik
Key Shareholders (with stake 5% or more):	
Associated Technologies (Private) Limited (100%)	

APPLICABLE METHODOLOGY(IES)

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

APPLICABLE RATING SCALE(S)

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

OVERVIEW OF THE INSTITUTION

Tower Power (Private) Limited (TPL) was incorporated in 2019 as a private limited company. TPL is a tower company (TowerCo) engaged in constructing, maintaining, and operating telecommunication passive infrastructure. The Company holds Telecommunication Tower Provider (TTP) license granted by Pakistan Telecommunication Authority (PTA). The registered office of the company is situated in Islamabad.

Profile of CEO:

Mr Mobashir A. Malik joined Associated Technologies as Director Technical in 1996, and moved up the ladder to become CEO in 2003. Under his leadership, the corporation has executed various network expansion projects for telecom service providers. In addition to this role, he also serves as a director for Nayatel (Pvt.) Limited and Pattern in Chief for Human Foundation.

RATING RATIONALE

The ratings assigned to Tower Power (Pvt.) Limited (TPL) incorporate TowerCo industry's medium- low business risk involving extensive lock-in periods, limited scope for termination and an escalation clause in built in the Service Agreement. 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. Moreover, the industry's long-term 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. However, business growth is expected to remain limited in the medium-term on account of macroeconomic weakening. In addition, the ratings factor in synergies available to TPL on the technical front as the parent organization serves as an EPC contractor.

The financial risk assessment takes note of high gross margins that are characteristic of TowerCo industry. However, the same does not translate into bottom line owing to sizable financial expense borne in line with reliance on long-term funding to meet capacity expansion targets. The ratings incorporate overall fair liquidity profile and efficient working capital management. Despite procurement of incremental long-term debt to fund capex, gearing and leverage indicators remained on a lower side and well aligned with the assigned ratings. The conservative capital structure is also underpinned by short-term debt free balance sheet as the Company enjoys negative cash conversion cycle; the same is an outcome of the absence of inventory turnover as tower construction is outsourced to ATL. Given, there are plans to mobilize borrowings in the near future to fund expansion of tower portfolio, gearing and leverage indicators are projected to increase slightly on a timeline by end-FY25. Subsequently, the ratings remain continent upon uptick in net margins and maintenance of liquidity and rangebound capitalization indicators along with successful materialization of growth targets.

<u>Spin-Off Arrangement</u>

TPL is a wholly owned subsidiary of Associated Technologies (Pvt.) Limited (ATL) and is primarily engaged in the provision of telecom infrastructure. The Company recently completed its spin-off from its parent organization, ATL on September 30, 2022. Resultantly, the entirety of ATL's tower portfolio, which included 666 towers, along with related assets, liabilities and customer contracts were transferred to TPL. The Company, consequently, issued shares corresponding to net assets to the tune of Rs. 8.1b, as per the business transfer agreement. Total assets registered by TPL amounted to Rs. 9.0b which included a re-measurement gain of Rs. 4.3b. On the other hand, total liabilities were recorded at Rs. 910.3m out of which Rs. 894.2m pertained to long-term financing while the remainder included liabilities incurred for employees' benefits. Owing to procedural delays on the part of associated banks, a portion of the loan portfolio that was planned to be transferred to TPL, amounting to Rs. 219m, is currently registered on ATL's books. As per management, the long-term finances will be fully shifted to TPL's books by end-1HFY24. The following is a brief of the transfer arrangement between the two companies:

Rs in m	NET COST	FAIR VALUE ADJUSTMENT	TOTAL
Assets			
666 BTS sites	4,711	4,255	8,965
Furniture & Fittings	2	0	2
Computer & Equipment	1	0	1
Total Assets	**4,714**	**4,255**	**8,968**
Liabilities			
Loan from National Bank of Pakistan	615	0	615
Loan from Dubai Islamic Bank	219	0	219
Loan from Dubai Islamic Bank	60	0	60
Employees Liabilities/Gratuity	16	0	16
Total Liabilities	**910**	**0**	**910**
Net Assets	**4,714**	**4,255**	**8,058**

Business Risk

TPL operates on a Built-to-Suit model wherein telecom operators contract the Company to construct towers as per their requirements. Towers can range from 30m to 60m in height and tenants are permitted to install antennas and other equipment on site. While majority of towers are powered by WAPDA, each site is backed-up by batteries according to frequency of loadshedding and remoteness from the grid. Additionally, off-grid sites are powered by generators. As per management, each site is also powered by solar panels with reverse metering capacity to reduce energy costs. TPL derives its competitive strength from sound experience and ATL's backward integrated facility; the associated company acts as an EPC contractor. As per management, the Company is currently not looking to expand its tower portfolio through the sale-and-lease-back model owing to the immense capital cost and prevailing high interest rates.

The TowerCo industry started with the establishment of the first TowerCo company in 2014. Market share of the industry is divided among 4 major players namely Engro Enfrashare, Edocto Pakistan (Pvt) Ltd, Awal Telecom and Associated Technologies (Pvt.) Limited (now the portfolio is held by Tower Power (Pvt) Limited). While the capital-intensive nature of the industry and high interest rate environment pose as significant barriers to entry, recent interest was shown by TPL Properties (through TPL REIT Management Company Ltd) in forming a consortium with TASC Towers – a UAE-based TowerCo to enter the market as well. As of end-FY22, 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 TowerCo companies. The market share for TowerCo industry (in terms of towers) in Pakistan is presented below.

Market share

Company name	2021	2022	2023
Engro Enfrashare	48%	50%	51%
Edotco	43%	42%	34%
Associated Technologies (now the portfolio is held by Tower Power (Pvt.) Limited)	8%	7%	14%
Awal Telecom	1%	1%	1%

While demand outlook of the TowerCo industry is expected to be suppressed in the medium-term given the current adverse macroeconomic conditions, the same is projected to pick up once economic indicators stabilize. The uptick is fueled by growth in data usage, localization of smartphone manufacturing and other government-level policy initiatives. This can be assessed through the uptrend in tele-density and annual mobile subscribers to 84.6% and 194.6m, respectively, at end-CY22 (CY21: 81.7%, 184.3m). Additionally, 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. As per management, with maturity of the tower portfolio, the overall industry tenancy ratio is projected to rise to 1.5x within the next five years.

Revenue and Profitability

The Company reported topline amounting to Rs. 2.8b (FY22: nil) during the outgoing year. However, given the spin-off was executed at end-Sep'23, this excludes net sales generated during 1QFY23 which were booked by ATL. The revenue emanates from two main sources: IPF (infrastructure provisioning fee) and energy charges (cost to energize the tower equipment). In addition to promote tower-sharing, TPL charges a slightly lower fee to additional tenants. The Company's client concentration risk is on higher side owing to the customer base constituting primarily of the 4 major telecom operators (Jazz, Telenor, Zong and Ufone) with Jazz dominating about 65-70% of business mix given its aggressive tower network expansion strategy. However, the associated risk is moderated by the long-term nature of contracts having lock-in periods of 10-12 years coupled with termination clauses in place which require the client to pay a fee for the remainder of the contract, ensuring stable revenue generation. In terms of geographic distribution, the tower network expands across the country, concentrated particularly in Punjab and KPK. However, due to the remote location of Gilgit-Baltistan and security concerns in Baluchistan, the outreach does not extend to these areas. As per management, no plans are underway to tap the aforementioned geographic domains either. Going forward, the Company projects additions of 185 and 116 towers to the overall portfolio during FY24 and FY25, respectively. Slowdown in tower demand is reflective of the challenging macroeconomic environment over the medium-term. However, the management predicts that demand backlog and growing network usage will result in sizeable uptick following stabilization of macroeconomic conditions.

Underpinned by nature of the business model, gross margins are generally high, recorded at 34.9% (FY22: nil) during FY23. TPL charges fixed annual 5% escalation on IPF rates and can negotiate higher base rates for new towers, ensuring higher setup costs are passed on to customers. Moreover, the Company has taken the green initiative of solarizing all the tower sites that not only helps boost profitability but also provides better quality of services to its customers in terms of improved power availability. The administrative costs, primarily entailing employee related costs, increased to Rs. 60.3m (FY21: Rs. 26.3m) during the outgoing year owing to full year operations. On the other hand, other income amounted to Rs. 4.9m (FY21: nil) constituting interest reaped on savings accounts and term deposits. It is pertinent to mention that the gross margins did not translate into bottom line as net margins stood markedly lower at 2.3% (FY22: nil) owing to considerable jump in financial expense to Rs. 624.0m (CY21: nil) during FY23. The escalation of financial expense was a combined outcome of increase in borrowings and policy rate hikes. Nevertheless, TPL reported positive bottom line worth Rs. 66.1m during FY23 as opposed to loss incurred to the tune of Rs. 26.3m in the preceding year. Going forward, the management predicts the gross margin to grow with improvement in tenancy ratios as the tower portfolio matures. However, given the reliance on debt-financing for tower construction and high interest rate environment, financing cost are expected to drag bottom-line profitability.

Liquidity

The liquidity profile improved during the rating review period as the Funds from Operations (FFO) were recorded significantly higher at Rs. 1.2b during FY23 in comparison to recorded in negative territory in the previous year; the same stemmed from successful initiation of commercial operations. Consequently, debt-servicing capacity was comfortable at 2.56x (FY21: nil) while FFO-to-total debt was also adequate at 0.26x (FY21: nil).

Trade receivables amounted to Rs. 776.5m (FY22: nil) at end-FY23; out of the total 95.1% were not past due nor impaired, depicting a healthy aging schedule. As per the management, the aging of receivables is satisfactory with no major credit losses incurred in the past. Moreover, contract assets pertaining to unbilled services provided to MNOs amounted to Rs. 316.5m (FY22: nil) while advances, prepayments and other receivables stood at Rs. 40.3m (FY22: Rs. 49.9m). The Company carries zero inventory given that all tower construction is outsourced to ATL which serves as an EPC contractor. Moreover, trade and other payables aggregated to Rs. 776.0m (FY22: 0.4m) majorly comprising of payables due to ATL pertaining to the transfer of the tower portfolio. Further, the current ratio was reported sound at 1.44x (FY22: 127.38x) at end of the outgoing year. In addition, ATL's liquidity profile is supported by the Company's negative cash conversion cycle resulting from the lack of inventory turnover as tower construction is completed by ATL. Going forward, cash flow coverages are expected to scale downwards on a timeline till end-FY25 owing to projected increase in financial expense on account of procurement of incremental long-term borrowing to fund tower portfolio expansion coupled with the high benchmark rate environment.

Capitalization

Following the execution of the business transfer agreement with ATL, the Company's Tier-1 equity stood at Rs. 8.2b (FY22: Rs. 50.6m) at end-FY23. On the flip side, total borrowings also increased to Rs. 4.7b including bank borrowing amounting to Rs. 3.2b and lease liability of Rs. 1.4b (FY22: nil). In line with industry norms, long-term borrowings were utilized primarily in the construction of new towers. The Company has a short-term debt free balance sheet as working capital requirements, primarily comprising of fuel expenses, are met through internal cash generation; the same has been positively in built in the assigned ratings. With sizeable equity base and zero short-term debt, gearing and leverage indicators remained low at 0.57x and 0.69x, respectively (FY22: nil, 0.01x). However, the quantum of debt is expected to grow going forward with the transfer of the remaining long-term loan from ATL by end-1HFY24 along with planned procurement of additional financing facilities totaling Rs. 1.8b and Rs. 812m in FY24 and FY25, respectively, to fund capex requirements. Consequently, gearing and leverage indicators are expected to scale upwards going forward; however, despite the increase the same are projected to remain within manageable range. Improvement in internal capital generation and maintenance of rangebound capitalization levels will remain imperative for ratings in the foreseeable future.

Financial Summary (Rs. in milllions)			(Appendix I)	
Balance Sheet	**FY22**	**FY23**	**FY24 (P)**	**FY25 (P)**
PPE	-	12,325	13,529	13,954
Trade Debts	-	776.5	313	369
Cash & Bank Balances	1	255	645	665
Total Assets	51	13,838	14,486	14,988
Trade and Other Payables	0.4	776	116	135
Long Term Borrowings (incl. lease liabilities)	-	4,660	5,802	5,808
Short Term Borrowings	-	-	-	-
Total Borrowings	-	4,660	5,802	5,808
Paid Up Capital	77	8,170	8,170	8,170
Total Equity	51	8,208	8,568	9,045
Income Statement				
Net Sales	-	2,837	3,802	4,491
Gross Profit	-	990	2,390	2,854
Profit Before Tax	(26)	310	415	784
Profit after Tax	(26)	66	230	477
Ratio Analysis				
Gross Margin	NA	34.9%	62.8%	63.5%
Net Margin	NA	2.3%	6.1%	10.6%
Net Working Capital	51	461	191	184
Current Ratio	127.38	1.44	1.25	1.22
FFO	(26)	1,213	943	1,212
FFO to Total Debt	NA	0.26	0.16	0.21
FFO to Long Term Debt	NA	0.26	0.16	0.21
Debt Servicing Coverage Ratio	NA	2.56	1.58	1.34
Gearing	-	0.57	0.68	0.64
Leverage	0.01	0.69	0.69	0.66
ROAA	-51.6%	1.0%	1.6%	3.2%
ROAE	-52.0%	1.6%	2.7%	5.4%
CCC (days)	NA	(27)	(63)	(0)

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	Tower Power (Private) Limited
Sector	Telecommunication
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				
21-02-2024	A-	A-2	Stable	Reaffirmed
05-10-2022	A-	A-2	Stable	Initial

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.
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.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Imran Ashraf	Chief Operating Officer	3 Nov, 2023
Mr. Farhan Masood	Deputy Manager Accounts	3 Nov, 2023