



PAKISTAN MOBILE COMMUNICATIONS LIMITED (PMCL)

RATINGS (NOVEMBER 2006)

PAKISTAN MOBILE COMMUNICATIONS LIMITED

	NEW	PREVIOUS
ENTITY		
Long Term	AA-	AA-
Short Term	A1	A1
TFCs		
Secured, listed (PKR 3,261mln)	AA-	AA-

FINANCIAL DATA

PKR (million)

	30-Jun-06*	31-Dec-05	31-Dec-04
Total Assets	100,360	82,656	45,928
Equity	16,453	14,268	9,272
Turnover	27,370	39,847	22,295
Net Income	2,185	5,918	4,893
ROA (%)	4.8^	9.4	13.7
ROE (%)	28.4^	50.2	67.2
EBITDA	8,972	15,072	10,827
EBITDA / Net Interest (x)	3.2	6.6	15.3
Net Debt / EBITDA (x)	2.0^	2.1	1.5
Net Debt / Equity (%)	218.3	224.5	176.5

* Based on audited results for 6 months period.

^ Simple annualized.

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TFCs ISSUE:

PMCL issued its first listed secured TFCs of PKR 3,261mln (inclusive of an exercised green shoe option of PKR 261mln) in May 2006. The issue has a tenor of seven years and principal is payable after a grace period of 4 years in 6 equal semi-annual installments. The issue is secured by way of first pari passu charges on two pools of assets with 25% margin. The first pool comprises present and future receivables and collections, and the second comprises present and future movable fixed assets of the company. The TFCs carry a coupon rate of 6 months KIBOR plus 285bps, with no floor or ceiling, being payable on a semi-annual basis in arrears. Considering a security structure that does not provide substantial additional comfort vis-à-vis all existing and future creditors, the TFC issue has been assigned a rating of 'AA-', that is, the same rating as the long-term entity rating.

RATING RATIONALE ASSESSMENT

- The ratings reflect PMCL's sustained market leadership in an increasingly competitive telecommunication industry. The company's capital structure is increasingly under stress due to continuing debt accumulation to fund aggressive network expansion. However, respective coverages, though declining, remain adequate and draw comfort from the company's robust cash flows. Meanwhile, the ratings also recognize improving financial profile of Orascom Telecom – the parent of PMCL.
- Pakistan's cellular industry, experiencing healthy growth over the recent years, is characterized by intense competition amongst operators to increase their respective subscriber base. This has resulted in a) a price-war exerting pressure on margins, and b) heavy capital expenditure to increase the outreach mainly funded through borrowings. Over the medium-term, though the trend is unlikely to change, it is expected to follow a decelerating rate. A large portion of incremental growth in cellular subscribers is expected to originate from price elastic low-end segments – semi-urban and rural areas – with weak brand loyalty. PMCL, despite experiencing decline in its market share, is the largest cellular operator serving slightly less than 50% of total mobile subscribers in Pakistan, the balance being shared by five other operators. However, expanding coverage by competitors, fortifying their competitive ability, is likely to further reduce PMCL's market share, though not substantially.
- PMCL has maintained remarkable pace of volume expansion during 2005 and the current year. However, average revenue per user (ARPU) and, in turn, margins are declining mainly due to incremental subscribers belonging to low-usage segments and successive price-cuts. In order to protect its margins, PMCL is working on a two-pronged strategy: a) minimizing the reduction in ARPU by offering differentiated products based on market segmentation and adding new services and features, and b) reducing the cost of operations by reducing reliance on PTCL's infrastructure, improving efficiency of its network and strengthening its international networking. In line with its strategy the company, inter-alia, has recently launched its PCO services. PMCL, through its subsidiary, is also laying down a countrywide optic fibre network. Going forward, given the likely saturation in cosmopolitan areas offering relatively higher ARPU, quality of services would be a critical differentiating factor amongst operators. Moreover, availability of mobile number portability facility in the near future, depending on its cost and ease of use, would benefit the operators with better quality. PMCL, mindful of these developments, is working towards improving all aspects of its services. Moreover, the company, with rich business experience, extensive international roaming arrangements and comprehensive domestic footprint providing it first-mover advantage at most locations, is well positioned in the changing market dynamics. At the same time, volume expansion is expected to largely mitigate the impact of contracting margins on profitability.
- PMCL has been relying extensively on borrowings to fund its aggressive network expansion resulting in a stressed capital structure (end-Jun 06 Debt:Equity - 71:29). The company's funding mix includes borrowings from domestic and offshore sources. Additionally, the company has arranged quasi-debt by negotiating extended repayment terms with a few of its equipment suppliers. Currently, it is in the process of raising another US\$ 250mln from international market, which, in addition to a partial debt swap, would be utilized mainly to finance ongoing capital expenditure. The recent period has been exceptional in terms of capital expenditure (06 estimate: PKR 45bln, 05: PKR 37bln). Going forward, the trend is expected to subside, which is likely to help in improving the capital structure. However, this would continue to be a function of the company's dividend policy.

- The company's cash flows, given the largely pre-paid nature of its business, increased in line with turnover. However, higher leverage resulted in decline in coverage ratios. Moreover, the company is exposed to a higher degree of financial risk on account of price risk emanating from the floating rate interest structure of its borrowings and currency risk arising due to its certain foreign currency liabilities. However, comfort can be drawn from the strong cash flows, providing liquidity to service obligations on timely basis. Recently, Pakistan Telecommunication Authority has restructured the payment pattern for license fee (US\$ 291mln), which has relieved some pressure on the company's cash flows.

BACKGROUND

- Pakistan Mobile Communications Limited (PMCL) is the country's largest cellular telecommunication service provider engaged in installation, operation and maintenance of a countrywide GSM cellular network under the brand name of Mobilink. PMCL, incorporated in December 1990 and commenced operations in August 1994, is an 89% owned subsidiary of Orascom Telecom Holding (OTH), based in Egypt. OTH, with a consolidated asset base of above US\$ 7,700mln at end-Jun 06 and listed on the Cairo and Alexandria Stock Exchanges in Egypt and the London Stock Exchange, is a fast expanding telecommunication company serving emerging markets across the Middle East, Africa and South Asia. PMCL continues to receive technological support from OTH.

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