The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Mobile Communications Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Apr-2018	AA-	A1	Positive	Maintain	-
14-Nov-2017	AA-	A1	Positive	Maintain	-
22-Mar-2017	AA-	A1	Positive	Maintain	-
22-Mar-2016	AA-	A1	Rating Watch	Maintain	-
30-Apr-2015	AA-	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Pakistan Mobile Communications Limited (PMCL) – majority owned by Veon (formerly VimpelCom) is the largest cellular operator in Pakistan. After acquiring Warid Telecom in July16, PMCL now commands 37% market share (~54mln subscribers at end-Jan18). With significant volumes, PMCL enjoys operational and technical network related synergies that are reflected in significantly better EBITDA and profitability of merged entity. PMCL completed marketing, technical, distribution and human resource integration in an efficient manner. Post-merger, PMCL has consolidated all its products and services under single brand 'Jazz'.

PMCL commands solid volumes and profitability; which gives it a strong business profile. EBITDA margins have improved to 49% in 9MCY17. The overall debt profile stays robust (EBITDA total debt payback = less than 3 years). Going forward, PMCL, while eying volumetric growth, is focusing on achieving better penetration in to existing base. Data services and mobile financial services are its key focus. The company marked a step in asset light operating model strategy; sale of Deodar wholly owned subsidiary with tower business to EdotCo (Malaysian based Company). This while freeing up financial sources, would enable focus towards core and differentiating services. PMCL, using the platform of Mobilink Microfinance Bank, an associate entity, intends to establish a strong digital banking platform. All these should enable PMCL to uphold its position in the competitive landscape. Launch of VEON app; is another step to capitalize data market industry of Pakistan.

The Positive Outlook is maintained which recognizes i) strong market positioning, ii) synergy gains in EBITDA and profitability margins; iii) adequate debt profile; iv) synergizing technological and distributional channels and v) potential of Jazz cash. Meanwhile, diversifying revenue channels while maintaining performance matrix would be improved. Moreover, timely settlement of TowerCo transaction is considered positive.

Disclosure	
Name of Rated Entity	Pakistan Mobile Communications Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Sukuk Rating Methodology(Jun-17),Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Communication(Apr-18)
Rating Analysts	Muneeb Rashid | muneeb.rashid@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

Pakistan Mobile Communications Limited (PMCL) Profile	
Incorporated	1990
Major Business	▪ Pakistan Mobile Communications Limited (PMCL) is the largest cellular telecommunication service provider of the country, engaged in installation, operation and maintenance of a countrywide GSM cellular network under the brand name of *Jazz*. PMCL holds six separate 2G licenses, one 3G, one 4G and one 4G/LTE license as part of Warid Telecom acquisition.
Legal Status	Unlisted
Head Office	Islamabad

Industry Snapshot

Pakistan's number of active cellular subscribers currently stands at ~146mln at end-Jan18. 3G/4G subscribers have attained 34% share in the total subscriber base. The industry expects further growth in data subscribers; thus expanding related network. However, as competitive landscape exists, average revenues per user (ARPUs) have yet to stabilize. Going forward, business potential in value added services is expected to provide impetus to revenue.

Ownership

- The ultimate ownership of PMCL lies with Veon (formerly Vimplecom). However, post-merger, after issuance of ~15% stake to Warid's sponsor Dhabi Group, its stake diluted to ~85%. The sponsor in the past has demonstrated support by investing in infrastructure capabilities of PMCL.
- PMCL makes an important part of Veon's operations; contributing ~20% (Dec16: ~17%) to Veon's EBITDA and 22% (Dec16: 21%) to total subscribers at end-Dec17.

Governance

- The seven-member Board of Directors (BoD) is mainly composed of representatives from Veon.
- The Board is chaired by His Highness Sheikh Nahayan Mabarak Al Nahayan. He heads the United Arab Emirates Ministry of Culture, Youth, and Social Development. He also chairs the board of the Abu Dhabi Group, Union National Bank and Bank Alfalah.
- The board comprises of three executive directors comprising CEO, CFO and the company secretary
- The board comprises highly qualified and experienced professionals holding senior positions in group companies

Management

- PMCL has an experienced top management team with requisite background and qualification. They are equipped with both local and foreign experience.
- Mr. Aamir Ibrahim – Ex CCO of Mobilink has been appointed as CEO of merged entity in July 16. He has over two decades experience of blue chip companies across various countries and industries but majorly of telecom sector. He has recently been appointed as the Head of Emerging Markets at Veon group level.

Systems & Controls

- The company has established strong systems and controls under the supervision of GTH and the same are continuously improving under the guidance of Veon.
- PMCL is using an analytical business intelligence reporting software to increase efficiency for employees and generate cost savings. The company has rolled out Oracle based ERP system which is fully integrated amongst all back-end departments of the company.

Performance

- Post-merger PMCL market share increased to 38% in terms of cellular subscribers at end-FY17 (FY16: 29%). In 7MFY18, PMCL continued on the growth trajectory by achieving growth of 3%, however, market share declined to 37% owing to accelerated growth amongst peers.
- During 9MCY17, PMCL's revenue clocked-in at PKR 113,313mln (9MCY16: 92,209mln) depicting a growth of 23% on YoY basis.
- In terms of ARPUs, voice ARPUs registered a decline of 7% on YoY basis, whereas, data ARPUs registered an increase of 30% on YoY basis
- Benefits of post-merger cost synergies have started materializing as operating expenses declined by 7% on YoY basis. Gross and EBITDA margins improved (GP: Sep17: ~42%; Sep-16: ~40%; EBITDA: Sep17: 49%; Sep16: 40%). As a result, net income of the company registered phenomenal growth of 162% (Sep17: ~PKR 17.3bln, Sep16: ~PKR 6.6bln).
- Bottom-line was amicably supported by higher revenue from site sharing facilities and reversal of activation tax.
- Going forward, focus would remain towards data monetization to improve profitability margins.
- The company also aims to become more agile/ lean. To this end PMCL entered into SPA in 2017 with EdotCo (a joint venture of Malaysian telecom group Axiata and Dawood Hercules group) to sell its passive tower infrastructure business which will free up assets to focus more on its core business.

Financial Risk

- The company maintains reasonably good cash conversion ratio; increased YoY basis (FCFO/sales Sep17: 41.3%, Sep16: 37.4%) due to higher profitability.
- FCFO of the company witnessed decent improvement of 36% (Sep17: 46,770mln, Sep16: PKR 34,515mln) owing to higher EBITDA. As a result, coverages improved slightly on YoY basis (FCFO/Gross Interest Sep17: 10.5x, Sep16: 10x).
- PMCL has a moderately leveraged capital structure and is expected to largely remain at the same level in CY18.
- The company has issued a Sukuk of PKR 6,900mln in two parts; PKR 3,000mln on Dec 22, 2014 and PKR 3,900mln on Sep 3, 2015. The profit is payable quarterly at three month KIBOR plus 35bps. The Sukuk has been provided a partial credit guarantee of PKR 966mln by GuarantCo, rated AAA by PACRA.

Pakistan Mobile Communications Limited PKR mln

BALANCE SHEET	30-Sep-17	30-Dec-16	30-Sep-16	31-Dec-15	31-Dec-14
	9MCY17(Cons.)	CY16 (Cons.)	9MCY16 (Cons.)	CY15 (Cons.)	CY14
Non-Current Assets	**202,720**	**215,286**	**212,910**	**128,851**	**137,047**
Investments (Others)	**-**	**-**	**1,783**	**-**	**5,301**
Current Assets	**64,937**	**30,891**	**29,134**	**13,954**	**11,553**
Inventory (Finished Goods)	365	234	337	433	222
Trade Receivables	6,202	6,399	6,400	3,412	1,980
Other Current Assets	46,353	7,919	7,020	7,252	3,821
Cash & Bank Balances	12,018	16,338	15,377	2,857	5,530
Total Assets	**267,657**	**246,176**	**243,826**	**142,805**	**153,901**
Debt	**92,640**	**77,266**	**77,101**	**45,098**	**40,875**
Short-term	-	-	-	-	-
Long-term (Inlc. Current Maturity of long-term debt)	**92,640**	**77,266**	**77,101**	**45,098**	**40,875**
Trade Payables	10,989	7,321	2,188	2,773	20,672
Due to Associates	-	-	-	-	136
Provision for Taxation	2,319	3,642	5,153	6,263	4,943
Other Liabilities	67,477	72,683	77,726	47,172	52,331
Shareholder's Equity	**78,388**	**80,264**	**81,659**	**41,499**	**34,944**
Total Liabilities & Equity	**251,812**	**241,176**	**243,826**	**142,805**	**153,901**

INCOME STATEMENT					
Turnover	**113,313**	**128,751**	**92,209**	**99,912**	**92,379**
Gross Profit	47,763	49,673	36,610	25,266	28,029
Operating Profit	24,529	17,162	11,506	589	7,193
Other Income	794	788	3,466	543	3,138
Financial Charges	(3,877)	(4,672)	(3,308)	(4,538)	(4,473)
Taxation	(12,619)	(7,136)	(4,995)	19	(8,957)
Net Income	**17,329**	**10,210**	**6,625**	**(1,223)**	**(1,438)**

Cashflow Statement					
Free Cashflow from Operations (FCFO)	46,770	45,243	34,515	38,753	32,760
Net Cash changes in Working Capital	(6,450)	10,305	1,766	(12,104)	10,758
Net Cash from Operating Activities	38,373	52,808	34,183	23,148	40,269
Net Cash from InvestingActivities	(50,591)	(23,705)	(12,870)	(24,997)	(67,840)
Net Cash from Financing Activities	7,902	(17,086)	(10,253)	(1,164)	20,681
Net Cash generated during the period	(4,317)	12,017	11,060	(3,014)	(6,891)
Closing Balance of Cash & Equivalents	12,018	16,338	15,377	3,637	5,530

Ratio Analysis					
Performance					
Turnover Growth	22.9%	28.9%	24.3%	8.2%	21.8%
Gross Margin	42.2%	38.6%	39.7%	25.3%	30.3%
EBITDA Margin	49.0%	39.1%	40.2%	41.9%	40.1%
Net Margin	15.3%	7.9%	7.2%	-1.2%	-1.6%
ROE	22.9%	10.0%	8.8%	-2.3%	-3.2%
Coverages					
Debt Service Coverage					
1. (FCFO/Gross Interest+CMLTD) (X)	2.2	1.8	2.1	2.1	2.5
2. (FCFO/Gross Interest+CMLTD+Uncovered STB) (X)	1.6	0.6	0.7	0.7	0.5
Interest Coverage					
1. (FCFO/Gross Interest) (X)	10.5	8.1	10.0	7.2	7.3
2. (EBITDA/Gross Interest) (X)	12.4	9.0	10.8	7.7	8.3
Liquidity and Cashflows					
Current ratio excluding CMLTD (X)	0.8	0.4	0.4	0.3	0.2
Net Cash Cycle (Inventory Days + Receivable Days - Payable	-21.8	-9.1	-4.0	-21.3	-120.0
Capital Structure (Total Debt/Total Debt+Equity)	56.4%	51.2%	48.6%	52.1%	53.9%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business, and economic environment.
CCC **CC** **C**	**Very high credit risk.** "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business or financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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