The Pakistan Credit Rating Agency Limited

Rating Report

Airlink Communication

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Dec-2020	A-	A1	Stable	Maintain	-
27-Dec-2019	A-	A1	Stable	Maintain	-
28-Jun-2019	A-	A1	Stable	Maintain	YES
31-Dec-2018	A-	A1	Stable	Upgrade	-
10-Jul-2018	BBB+	A2	Stable	Maintain	-
29-Dec-2017	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings denote Airlink’s adequate operational sustainability underpinned by its solid market position and diversified earnings from its mobile distribution business. Over the last few years, the Company has improved its business profile. Topline is witnessing an ample growth on a Year-on-Year basis owing to the formidable demand of mobile handsets in the country. Global tension among Huawei and USA were expected to hamper the business volumes of the country. However, Airlink has been successful in subduing the challenge by replacing the foregone Huawei offtake with the sales of a new brand - Tecno. Additionally, sales of new brands including Apple, Itel & Alcatel have also augmented the topline. With its legal status converted to a Public Unlisted Entity in Apr'19, several improvements in the governance structure are witnessed including induction of three independent directors. Move is on the horizon for public listing. The company’s import driven business model is mandated to be secured against cash margin with insurance for the in-transit; short term debt book, therefore, appears ballooned on account of regulatory compliance of import contracts - effective working capital strategies are imperative. Financial risk profile is demonstrated by sanguine free cash flows from operations (FCFO) and leveraged capital structure.

The ratings are dependent on the company’s ability to sustain its relative position and positive performance indicators amidst growth. As business volumes grow, prudent financial discipline - particularly in capital structure, is essential to uphold the ratings.

Disclosure

Name of Rated Entity	Airlink Communication
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Mobile Phone and Allied Products(Jun-20)
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Mobile Phone and Allied Products

Profile

Legal Structure Airlink Communication Limited (herein referred to as "Airlink" or "the company") is a Public Unlisted Company that was incorporated as a Private Limited Company in 2014 with the SECP under Companies Ordinance, 1984 (now Companies Act, 2017). Airlink converted its status to Public Unlisted in Apr'19.

Background Airlink was formed in 2010 as a partnership firm for the import and distribution of IT products, particularly mobile phones, and related services. In 2014, a new private company was incorporated simultaneously to take over the business of the partnership firm running as a family business. Following July 2018, the entire business of the partnership has been transferred to the company's books.

Operations Airlink is principally involved in the distribution of mobile phones and allied products of the two leading brands in the mobile industry; Huawei and Samsung. The company has also been awarded the distribution rights of iPhone in the country, in collaboration with a Singaporean group. Additionally, the company has also signed an agreement with Tecno, Alcatel and Mi for distribution services. Airlink is associated with Huawei and Samsung, since 2012 and 2016 respectively.

Ownership

Ownership Structure The company is owned by the sponsoring family; formerly by the brothers - Mr. Muazzam Hayat Piracha (Late) and Muzaffar Hayat Piracha (~40.6%). After the death of Mr. Muazzam Hayat Piracha, his shares have been transferred to his wife, Ms. Saliha Basit (~4.5%) and his four daughters (~6% each). Mr. Shaukat Hayat Piracha, paternal uncle of the two owners, has lately transferred his stake to his son, Mr. Yasir Hayat Piracha, who now owns ~29.7% shares in the company.

Stability The ownership structure will change in the near future, in light of the proposed listing of the company, on the PSX. The share of the sponsors will contract proportionally.

Business Acumen Mr. Muzzaffar Hayat - the main sponsor, is leading the company since its inception. He is a seasoned professional possessing strong understanding of the industry. Business acumen is, thus, considered good.

Financial Strength Owners of the company do not have any strategic stake in other companies. Mr. Muzaffar owns residential properties. Financial strength is, therefore, considered adequate.

Governance

Board Structure Airlink has transformed its governance structure to comply with the Code of Corporate Governance, for which appointment of three independent directors has been made. Other than the independent directors, there are four members on the Board.

Members' Profile Board member's business acumen is considered good as they have vast experience of the relevant industry. Mr. Aslam Hayat Piracha, carrying extensive experience in the relevant field, is the Chairman of the Board.

Board Effectiveness The Board has two sub-committees; Audit and HR & Remuneration Committee, which enables the Board to keep an oversight of the business more closely.

Financial Transparency An Internal Audit Department, reporting independently to the Audit Committee, is in place. EY Ford Rhodes Chartered Accountants are the External Auditors of the company, categorized as an 'A' rated firm by SBP. They have expressed an unqualified opinion on the company's financial statements for 1HFY20. Financial statemented for FY20 are in process of being audited.

Management

Organizational Structure Airlink has a well-defined organizational structure and various types of activities are properly segregated and managed through different departments. The department heads report to the CEO.

Management Team Mr. Muzaffar Hayat Piracha, CEO of the company, is an MBA and has been associated with the company since its inception. He is involved in all strategic and key decisions of the company.

Effectiveness There are six management committees operating namely as; i) Credit Committee, ii) Risk Management Committee, iii) Sale Control Committee, iv) Cash Management Committee, v) Operational Control Committee and vi) Business Plan Committee, which help in ensuring operational efficacy.

MIS Airlink has installed SAP - an ERP solution as its information system, which provides adherence to a sound reporting system within the company.

Control Environment MIS reports for senior management are generated frequently and are detailed in nature. Many reports, including the following, are generated frequently of each business unit: i) region wise business partner report including adjustments, ii) daily stock report for all warehouses, iii) product wise report of region and corporate limits.

Business Risk

Industry Dynamics The country's teledensity increased from 6% in FY04 to a high of 79% in FY20. Smartphone penetration in the total mobile phone market is growing, with further potential for growth, especially in the low cost segment. The industry is entirely dependent on imports. As the countrywide lockdown has eased up, the short term demand side mechanics, paint a positive picture. However, at the same time, the devaluation of currency against USD and the rise in duty structure has amplified the prices of imported phones, thus putting pressure on the demand of high-end range mobile phones. Yet, import volumes have increased in FY20, compared to the corresponding period. In FY20, Samsung was the most imported brand, followed by Huawei and Oppo. Imposition of Device Identification Registration and Blocking System (DIRBS) has reduced the proportion of grey channel import market in the system, which is another added benefit to the legal authorized importers.

Relative Position Airlink is one of the 4 mobile phone distributors of the country. The company is working with the world's top brands of mobile phones. Samsung (43%), Huawei (22%) and Tecno (22%) contribute the highest to the company's revenue, followed by Itel (7%), Apple (4%) and Alcatel (1%). Recent award of distribution rights of Alcatel and Mi phones will further aid in sustaining the market share of the company, by penetration in diverse customer segments.

Revenues During FY20, the company recorded a topline of PKR~43,008mln (FY19: PKR~29,786mln), depicting a substantial growth of 44.5%, compared to the corresponding period. Rising prices have played a major role in expanding the topline. As Huawei's quantum share declined during the period, diversity, including iPhone and Tecno distribution, was initiated to keep the business volumes intact.

Margins A decline in the margins was noted, during the period. In FY20, gross profit margins fell to 11% (FY19: 13.4%), mainly as a result of a rise in the duty structure, nullifying the effect of higher pricing of the products. Further reason of lower margin was change in product mix. A similar trend was noted in the net profit margins (FY20: 3.5%, FY19: 5.0%). A rise of ~70% in finance cost due to higher average interest rates, contributed to a less healthy bottom line.

Sustainability As a result of the pandemic Covid-19, a major disruption in the supply chain was noted in the second half of FY20. A gradual ease in lockdowns worldwide, has eventually provided relief, in this regard. However, second wave of Covid19 has led again to uncertain situation. Agreements for distribution of Apple and Tecno products, along with the recent distribution agreement with Alcatel and Mi, has played a major role in mitigating the concentration risk.

Financial Risk

Working Capital Working capital requirement emanates from financing trade receivables and inventory. Since the imposition of SBP's directive to maintain 100% margin for Line of Credit (LC), working capital needs have elevated. Short term borrowings (STBs) have also gone high on the scale. Thereby, the company's short term trade leverage has gone negative depicting no further cushion of trade assets available against STBs. The average gross working capital days, albeit still high, have improved as a result of a fall in trade receivables (FY20: 66 days, FY19: 75 days). A similar trend was noted in the average net working capital days of the company (FY20: 29 days, FY19: 42 days).

Coverages Core operating coverages have been part of a falling trend mainly due to an increased interest cost (FY20: 2.2x, FY19: 3.0x). Debt payment capacity, though, currently remains comfortable.

Capitalization Total debt of the company remains high, with it clocking in at PKR~9,209mln, as at end-FY20 (FY19: PKR~7,873mln). The company has a highly leveraged capital structure. As at End-FY20, leveraging stood at 66.9% (FY19: 72.1%). Most of the debt book is composed of short term loans to manage working capital needs. Cautious management approach is necessitated.

PKR mln

Airlink Communication Limited Communication	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET			
1 Non-Current Assets	347	323	130
2 Investments	702	2,490	1,226
3 Related Party Exposure	-	-	-
4 Current Assets	19,569	12,155	8,830
a Inventories	*4,617*	*1,118*	*2,171*
b Trade Receivables	*4,707*	*5,125*	*3,882*
5 Total Assets	20,618	14,968	10,187
6 Current Liabilities	6,728	3,930	3,227
a Trade Payables	*6,096*	*2,611*	*2,838*
7 Borrowings	9,209	7,873	4,286
8 Related Party Exposure	64	72	-
9 Non-Current Liabilities	29	23	17
10 Net Assets	4,587	3,069	2,656
11 Shareholders' Equity	4,587	3,069	2,656
B INCOME STATEMENT			
1 Sales	43,008	29,786	24,151
a Cost of Good Sold	*(38,231)*	*(25,799)*	*(21,004)*
2 Gross Profit	4,776	3,986	3,147
a Operating Expenses	(928)	(740)	(515)
3 Operating Profit	3,849	3,246	2,632
a Non Operating Income or (Expense)	*164*	*176*	*46*
4 Profit or (Loss) before Interest and Tax	4,013	3,422	2,678
a Total Finance Cost	*(1,403)*	*(827)*	*(388)*
b Taxation	*(1,091)*	*(1,115)*	*(1,056)*
6 Net Income Or (Loss)	1,519	1,480	1,234
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*2,663*	*2,248*	*1,647*
b Net Cash from Operating Activities before Working Capital Changes	*1,429*	*1,833*	*1,349*
c Changes in Working Capital	*(3,694)*	*(4,660)*	*(1,524)*
1 Net Cash provided by Operating Activities	(2,266)	(2,827)	(175)
2 Net Cash (Used in) or Available From Investing Activities	(29)	(11)	(1,282)
3 Net Cash (Used in) or Available From Financing Activities	2,827	2,730	1,513
4 Net Cash generated or (Used) during the period	532	(109)	56
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	44.4%	23.3%	81.9%
b Gross Profit Margin	11.1%	13.4%	13.0%
c Net Profit Margin	3.5%	5.0%	5.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-2.4%	-8.1%	0.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	38.4%	57.4%	59.2%
2 Working Capital Management			
a Gross Working Capital (Average Days)	66	75	75
b Net Working Capital (Average Days)	29	42	43
c Current Ratio (Current Assets / Current Liabilities)	2.9	3.1	2.7
3 Coverages			
a EBITDA / Finance Cost	3.0	4.5	7.5
b FCFO / Finance Cost+CMLTB+Excess STB	2.1	3.0	4.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.8	0.6	0.0
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	66.9%	72.1%	61.7%
b Interest or Markup Payable (Days)	49.1	117.8	51.3
c Entity Average Borrowing Rate	14.6%	12.1%	11.1%

Credit Rating

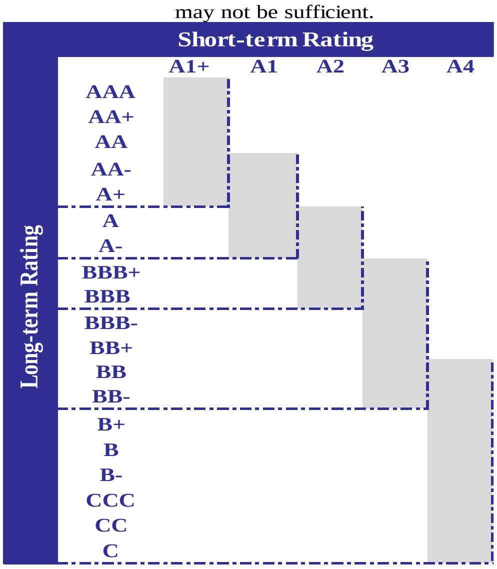
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 and in 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.** Substantial 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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

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/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'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

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, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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)
Proprietary Information