The Pakistan Credit Rating Agency Limited

Rating Report

Nayatel (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Mar-2019	A	A1	Stable	Maintain	-
07-Sep-2018	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The strength of Nayatel's business model is in its robust technology infrastructure with an enduring emphasis on customer services. Reliable connectivity and quality is pivotal to all customers. Nayatel provides connectivity to its customer through scalable and cutting edge technology, i.e., FTTH (fiber to the home). An Optical fiber as a medium is superior to the other alternatives to provide ultra-broadband, high definition cable TV and allied services. With better customer experience, sustainability and growth, Nayatel has made corporate and home market of Islamabad and Rawalpindi its strong forte, wherein it captures the bulk of the market. The customer base reflects a very good mix, providing advantages in terms of pricing, margin and capacity utilization. The volumes are growing, so are the profits. The company's revenue from Faisalabad region is growing at a steady pace. Moreover, it has also commenced operations in Peshawar since 2HCY18. Future expansion plans reflect penetration into bigger cities over a longer horizon with augmented equity base. The company has raised leveraging to fund its expansions. The current and foreseeable cash flows are expected to meet the upcoming obligations. The governance of the company is considered strong with an inherent strength emerging from its ownership structure.
The company has a talented and motivated management team. The top executives are closely connective hence team cohesiveness is an advantage. The overall pool of management reflects quality human resource and performance driven culture, which is considered a pre-requisite in this business.

The ratings are dependent upon the sustained risk profile of the company. This presupposes sustained technological and HR advantages of the company, which Nayatel is carrying at the moment. Financial discipline is also considered essential, going forward.

Disclosure	
Name of Rated Entity	Nayatel (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Communication(Apr-18)
Rating Analysts	Nadeem Sheikh | nadeem.sheikh@pacra.com | +92-42-35869504

Profile

Legal Structure Nayatel (Private) Limited (herein referred to as "Nayatel" or "the company) is a Private Limited Company incorporated as a wholly owned subsidiary of Micronet Broadband Private Limited in 2004.

Background The company was incorporated under the Companies Ordinance, 1984 (now "Companies Act, 2017"), for the purpose of launching fiber to the home (FTTH) technology to provide ultra broadband , telephone and high definition television services in Pakistan. Micronet Broadband (Pvt) Ltd (MBL), the parent company of Nayatel, was formed by Micronet Group in December 2001. The Micronet Group consists of professionals who have been at the forefront of Internet wave when it was introduced in Pakistan in the mid-nineties. MBL was founded by this group with the sole aim of rolling out first ever broadband services and solutions in Pakistan.

Operations Nayatel uses FTTH technology; the company operates in Islamabad, Rawalpindi and Faisalabad. It has also recently launched operations in Peshawar (2HCY18). Nayatel has a diversified platform of services including public and private data network services, fixed line telephony services, cable television and other value added services.

Ownership

Ownership Structure Nayatel is owned by Micronet Broadband (Pvt.) Limited (MBL). MBL's ownership comprises of 3 groups of investors; i) MBL's original shareholders, ii) Mr. Rashid Khan and iii) Mr. Ashraf Qazi.

Stability The company has a sound and stable ownership structure.

Business Acumen Nayatel's business model was conceived by three of MBL's founding members; i) Wahaj us Siraj ii) Aqeel Khurshid & iii) Khawaja Saad Saleem. All three of the founders are thorough professionals and closely connected friends. All three of them are engineers – cum – entrepreneur. Rashid Khan is a seasoned senior Business Executive with extensive experience in banking and finance, consumer marketing and corporate restructuring initiatives.

Financial Strength Financial strength of the sponsors is considered adequate.

Governance

Board Structure The board of directors (BoD) consists of 6 directors with equal number of executive and non-executive directors. No independent director on the BoD exists.

Members' Profile The Board members have a strong professional background which brings ample experience and knowledge to the board.

Board Effectiveness The board, having a blend of seasoned entrepreneurs and financial experts, supports the management in terms of strategic guidance.. Albeit, no formal board committee exists.

Financial Transparency The external auditors of the company are Grant Thornton & Co. Chartered Accountants. A separate Internal Audit department is also in place.

Management

Organizational Structure Nayatel has a well-defined organizational structure and different operational activities are properly segregated and managed through different departments. All department heads report to the Chief Executive Officer (CEO). All technical departments terminate into the Chief Technology Officer (CTO) and the operational departments report to Chief Operating Officer (COO).

Management Team Mr. Wahaj Siraj is the CEO and co-founder of Nayatel. He had also co-founded Micronet Broadband (Private) Limited, the first one to launch broadband Digital Subscribers Line (DSL) services in Pakistan in 2002. Mr. Siraj has a vast experience in Internet and telecom industry and has also worked with the Government of Pakistan at policy formulation level. He is assisted by an experienced management team to run the business. Khwaja Saad Saleem, COO, is the brain behind FTTH network design of Nayatel and its deployment areas of the company's network Mr. Aqeel Khurshid, CTO, is an engineer from UET Lahore and possesses a wealth of experience in the Telecom Sector.

Effectiveness The company has a sound Supply Chain Management process for the purchases and sales requiring approval from the CEO, COO, CTO and CFO.

MIS SAP has been implemented at Nayatel. The implementation and establishment of SAP system was done by Siemens Pakistan. The practice of monthly reporting is prevalent in the company. Management meetings take place on a monthly frequency to discuss the company's financial position and future strategy.

Control Environment The company has a sound internal control environment. Nayatel also has its own patrolling team, looking after the fiber cuts at its operation sites. Nayatel Fiber Service Division (NFSD) has installed fiber to the home (FTTH) network in four cities of Pakistan, Islamabad, Rawalpindi, Faisalabad and Peshawar. Nayatel also has its own patrolling team, looking after the maintenance of its network.

Business Risk

Industry Dynamics Demand for internet broadband is robust and the increase in urbanization will also add to the overall customer base of the industry. Customers are willing to pay premium prices in exchange of uninterrupted broadband. With a handful of internet providers operating in the country coupled with high barrier to entry, there is room for each player to increase its market share.

Relative Position The company operates under the licenses issued by PTA and PEMRA. Nayatel has obtained 11 licenses altogether, six loop licenses, four cable TV licenses and one CVAS license. All of these licenses have been obtained from PTA and PEMRA. Subsidiaries of Nayatel i-e., Metrotel Private Limited and Super Dialogue Private Limited, also have Wireless Local Loop license with spectrum of two telecom regions. In terms of technology, FTTH is the latest and rapidly growing business. Nayatel was the first to launch FTTH in Islamabad where they have the bulk of the market. The customer base reflects the elite corporate entities and institution. They provide a stable and profitable source of income to Nayatel.

Revenues Nayatel's revenue increased by ~17.5% during 9MCY18 on YOY basis. The company posted a revenue of PKR~2,119mln during 9MCY18 (9MCY17: 1,747).

Margins Gross profit margin increased to ~40% during 9MCY18 as compared to ~34%% during 9MCY17. Improved gross profit margin translated into improved net profit margins.

Sustainability Revenue of the company is expected to increase in the coming periods streaming from operations in Peshawar. The revenue from Faisalabad region had showed tremendous growth during last year. Topline is therefore, expected to pick up in the coming years.

Financial Risk

Working Capital Average inventory days decreased to ~27 days at the end of 9MCY18 (~31 days 9MCY17). Net working capital days slightly increased to ~32 days during 9MCY18 as compared to ~30 days during 9MCY17. The company's billing pattern is usually cycled around one month.

Coverages Free cash flow from operations (FCFO) increased by ~62% on YOY basis in 9MCY18 clocking in at PKR~790 million (9MCY17: PKR~487 million). 9MCY18 witnessed an increase in FCFO on the backdrop of increased profits. This has led the debt coverages to remain stable, despite an uptick in the interest costs borne on the loans obtained to fund CAPEX.

Capitalization Gearing ratio remained relatively stable during the period as it recorded at ~38% at the end of 9MCY18 (CY17: ~37%). Total borrowings clocked in at PKR~2,274mln largely dominated by long term liabilities which recorded at PKR~2,221mln. Long term liabilities were obtained to incur expansions in the business.

The Pakistan Credit Rating Agency Limited | PKR mlm

Nayatel (Private) Limited

BALANCE SHEET	Sep-18	Dec-17	Dec-16	Dec-15
	9M	12M	12M	12M
a Non-Current Assets	**5,880**	**5,425**	**2,936**	**1,938**
b Investments (Incl. Associates)	**22**	**22**	**22**	**22**
Equity Instruments	22	22	22	22
Debt Instruments	-	-	-	-
c Current Assets	**1,125**	**1,065**	**834**	**792**
Inventory	226	196	184	199
Trade Receivables	388	327	236	204
Others	511	543	414	389
d Total Assets	**7,028**	**6,512**	**3,792**	**2,753**
e Debt/Borrowings	**2,274**	**1,993**	**1,025**	**297**
Short-Term	53	60	113	-
Long-Term (Incl. Current Maturity of Long-Term Debt)	2,220	1,933	912	297
Other Short-Term Liabilities	299	375	192	241
Other Long-Term Liabilities	711	734	378	288
f Shareholder's Equity	**3,744**	**3,411**	**2,197**	**1,927**
g Total Liabilities & Equity	**7,028**	**6,512**	**3,792**	**2,753**

INCOME STATEMENT				
a Turnover	**2,119**	**2,405**	**2,043**	**1,757**
b Gross Profit	845	757	729	703
c Net Other Income	19	30	47	50
d Financial Charges	(121)	(12)	(51)	(30)
e Net Income	**300**	**165**	**267**	**328**

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	790	544	471	712
b Total Cashflows (TCF)	790	544	471	492
c Net Cash changes in Working Capital	(152)	44	32	(89)
d Net Cash from Operating Activities	518	577	449	374
e Net Cash from InvestingActivities	(811)	(1,497)	(1,252)	(888)
f Net Cash from Financing Activities	293	997	595	566
g Net Cash generated during the period	(0)	78	(209)	53

RATIO ANALYSIS				
a Performance				
Turnover Growth	17%	18%	16%	39%
Gross Margin	40%	31%	36%	40%
Net Margin	14%	7%	13%	19%
ROE	11%	6%	13%	17%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.4	1.2	2.3	6.6
Interest Coverage (X) (FCFO/Gross Interest)	6.5	43.6	9.2	24.1
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	2.5	3.6	2.2	0.4
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	32	30	35	-7
Capital Structure (Total Debt/Total Debt+Equity)	38%	37%	32%	13%

Rating Scale

Credit Rating Scale & Definitions

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.

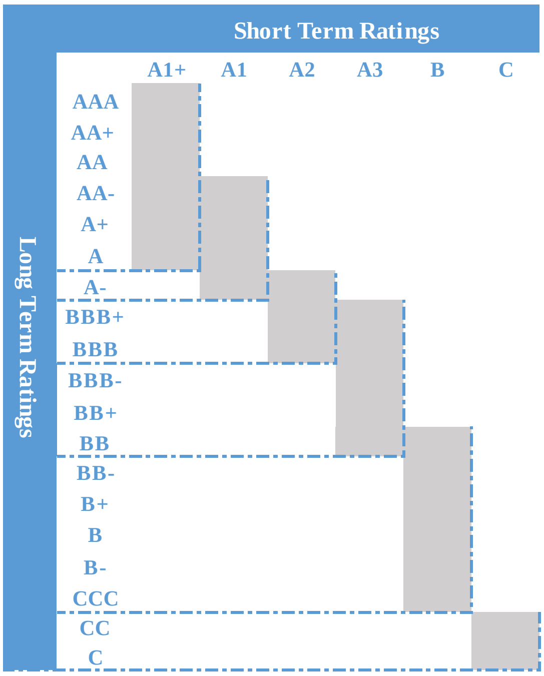
Long Term Ratings

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 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 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.

Short Term Ratings



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

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)
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