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
07-Nov-2018	AA-	A1	Positive	Maintain	-
27-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	-

Rating Rationale and Key Rating Drivers

The ratings incorporate robust business profile of the company, represented by a leading market share of ~37% in the country's cellular subscribers (~56 million). This strong share has been achieved with organic and inorganic growth. The company enjoys synergies related to operational and technical network, reflected into better earnings for the merged entity. Optimizing on its single brand "Jazz", the company commands solid volumes and strong margins. Additionally, in collaboration with Mobilink Microfinance Bank, an associate entity, the company is establishing a strong digital banking platform. Overall market dimensions remain positive, particularly in mobile data services, as penetration level in 3G/4G subscribers stands at ~29%, depicting sufficient room for growth. Despite the growing trend, over-the-top (OTT) applications continue to be of challenge to the telecom revenues. The company's financial risk profile exhibits a strong outlook demonstrated by prudent working capital strategies and comfortable coverages. Capital structure reflected a relatively leveraged position and is expected to dilute, going forward, as the company pays off its long term debts, supported by robust and sustainable cashflows.

The ratings are dependent on the sustenance of (i) leading market position (ii) strong profitability and (iii) adequate debt profile. Meanwhile, extending growth in mobile data services is considered important.

Disclosure

Name of Rated Entity	Pakistan Mobile Communications 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 Incorporated in 1990, Pakistan Mobile Communication Limited ("the company") is a public unlisted company. The head office of the company is located in Islamabad.

Background The company was formerly known as Mobilink. However, after the merger with WaridTel Pakistan beginning 2016, both companies re-launched under the brand name "Jazz".

Operations The company 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 "Jazz". It holds six separate 2G licenses, one 3G, one 4G and one 4G/LTE license as part of Warid Telecom acquisition.

Ownership

Ownership Structure Ownership of the company lies with Veon (formerly Vimplecom). However, after issuance of ~15% stake to Warid's sponsor - Dhabi Group, following merger, its stake diluted to ~85%.

Stability Stable ownership structure with clear representation on the governance bodes well for the company.

Business Acumen The company's ultimate sponsor - Veon is a multinational telecommunication services company, headquartered in Amsterdam, Netherlands. It is the sixth largest mobile network operator in the world by the number of subscribers. Most of the company's revenue streams from Russia and Italy. Sponsor acumen is, therefore, considered strong.

Financial Strength Veon - the ultimate parent, has investments and shareholding in a number of companies forming part of the group, spread across a widespread geographical scale.

Governance

Board Structure The Board of Governance is composed of seven members, including the CEO. Most of the members are representative of Veon.

Members' Profile The Board members are equipped with profound knowledge and expertise of the related business. The board includes three executive directors, including the CEO, CFO and the Company Secretary.

Board Effectiveness Attendance recorded during the board meetings was satisfactory for the period under review. Board Committees

Financial Transparency M/S. A.F. Ferguson & Co. Chartered Accountants, one of the big four network firms, are the External Auditors of the company.

Management

Organizational Structure The company has a well-defined organizational structure with clear lines of responsibility and cadre dedicated within each department.

Management Team An experienced top management team with requisite background and qualification manages the operations. They are equipped with both local and foreign experience. Mr. Aamir Ibrahim – Ex CCO of Mobilink is the CEO of merged entity since 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.

Effectiveness All operations are monitored at the Department head level. KPIs and performance appraisal system to boost operational efficiencies are in place. The company has formally designated Management Committees for oversight of efficiency management.

MIS The company 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.

Control Environment Strong systems and controls under the supervision of GTH are established and the same are continuously improving under the guidance of Veon.

Business Risk

Industry Dynamics Pakistan Mobile Telecom Sector is composed of four players; Jazz, Telenor, Zong and Ufone. The industry has experienced various changing trends in the past few years due to smartphone penetration and emergence of high speed data service needs. Competition has grown on a timeline basis, with Over-the-top (OTT) apps posing significant challenge to the cellular mobile operators. Total number of cellular subscribers has reached to152 million users by Sep-18 (penetration of ~73% of the total market) and 3G/4G subscribers have reached to 59 million users (penetration of 29%).

Relative Position The company relishes on a share of ~37% in market cellular subscribers, demonstrating a strong foothold in the segment, specially taking a boom after merger with WaridTel. It also has the highest number of 3G subscribers in the country, whereas in 4G technology, Zong takes the lead.

Revenues The company's consolidated revenue clocked in at PKR~78,199mln in 1HCY18, indicating a growth of ~5% YoY basis. Topline for CY17 was recorded at PKR~151,196mln.

Margins Cost synergies achieved on the backdrop of merger with WaridTel has significantly reduced the operating costs of the business, thus improving the trend line of gross margins on a timeline basis. The trend of growth in gross profit margin is reflected as follows; 1HCY18: ~48%, CY17: ~43%, CY16: ~39%, CY15: ~25%. Net margin, however, declined to ~11% in 1HCY18 (CY17: ~14%) as a consequence of high deviant tax payments during the period, in application of the changes in Finance Act, 2018.

Sustainability During CY17, the company entered into sale purchase agreement (SPA) with EdotCo (a joint venture of Malaysian telecom group Axiata and Dawood Hercules group) to adopt "asset light business model" and sell its passive tower infrastructure business. The deal, however, got cancelled in Sep-2018 due to absence of regulatory approval. The company is now seeking on different strategies to settle the transaction. Digitalization and broadband services are the key current strategical features.

Financial Risk

Working Capital Cash conversion cycle is kept reasonably effective. Working capital is a function of the company's receivable and creditor days, which recorded at ~15 and ~14 days respectively during 1HCY18 (CY17: ~15 and ~24 days). Cash conversion ratio (FCFO/Sales) increased to ~43% in 1HCY18 (CY17: ~41%).

Coverages During 1HCY18, interest coverage remained strong, i.e., 9.3x (CY17: 11.6x), however, core and total coverages remained just above the line, due to a high portion of current maturity of long term debt. Going forward, in 2019, the company is expected to incur a wholesome expense on renewal of 2G spectrum acquired through Warid Telecom.

Capitalization The company's debt burden is concentrated in long term borrowings amounting to PKR~84,874mln as on End-June'18 (End-Dec'17: PKR~97,590mln). Short term borrowings are trivial, representing good working capital strategies. Equity stood at PKR~73,286mln as at End-June'18 (End-Dec'17: PKR~62,869mln), thereby forming a relatively leveraged capital structure, i.e., ~54% (End-Dec'17: ~61%). Going forward, with no major borrowings or short-term loan support, the leveraging is expected to dilute.

Pakistan Mobile Communications Limited — PKR mln

BALANCE SHEET	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
	2Q (Cons.)	CY17 (Cons.)	CY16 (Cons.)	CY15 (Cons.)
Non-Current Assets	**199,608**	**198,861**	**215,286**	**128,851**
Investments (Others)	**11,229**	**1,353**	-	-
Current Assets	**56,228**	**58,653**	**30,891**	**13,954**
Inventory (Finished Goods)	423	208	234	433
Trade Receivables	5,472	4,705	6,399	3,412
Other Current Assets	48,678	46,589	7,919	7,252
Cash & Bank Balances	1,655	7,151	16,338	2,857
Total Assets	**267,064**	**258,867**	**246,176**	**142,805**
Debt	**83,707**	**96,457**	**77,266**	**45,098**
Short-term	92	-	-	-
Long-term (Inlc. Current Maturity of long-term debt)	**83,614**	**96,457**	**77,266**	**45,098**
Trade Payables	14,549	11,094	7,321	2,773
Due to Associates	-	-	-	-
Taxation	2,390	1,925	3,642	6,263
Other Liabilities	93,131	86,523	77,683	47,172
Shareholder's Equity	**73,286**	**62,869**	**80,264**	**41,500**
Total Liabilities & Equity	**267,064**	**258,868**	**246,176**	**142,805**

INCOME STATEMENT				
Turnover	**78,199**	**151,196**	**128,751**	**99,912**
Gross Profit	37,339	64,985	49,673	25,266
Operating Profit	20,545	31,827	17,162	589
Other Income	114	825	788	543
Financial Charges	(3,638)	(5,376)	(4,672)	(4,538)
Taxation	(11,823)	(16,255)	(7,136)	19
Net Income	**8,208**	**20,746**	**10,210**	**(1,223)**

Cashflow Statement				
Free Cashflow from Operations (FCFO)	33,708	62,258	45,243	38,753
Net Cash changes in Working Capital	3,964	(5,874)	10,305	(12,104)
Net Cash from Operating Activities	32,673	52,606	52,808	23,148
Net Cash from InvestingActivities	(15,379)	(58,002)	(23,705)	(24,997)
Net Cash from Financing Activities	(13,602)	(2,666)	(17,086)	(1,164)
Net Cash generated during the period	3,693	(8,062)	12,017	(3,014)
Closing Balance of Cash & Equivalents	12,884	7,151	16,338	3,637

Ratio Analysis				
Performance				
Turnover Growth	5%	17%	29%	8%
Gross Margin	48%	43%	39%	25%
EBITDA Margin	52%	48%	39%	42%
Net Margin	10%	14%	8%	-1%
ROE	16%	22%	9%	-1%
Coverages				
Debt Service Coverage				
1. (FCFO/Gross Interest+CMLTD) (X)	2.2	1.9	1.8	2.1
2. (FCFO/Gross Interest+CMLTD+Uncovered STB) (X)	0.9	0.8	0.6	0.7
Interest Coverage				
1. (FCFO/Gross Interest) (X)	9.3	11.6	8.1	7.2
2. (EBITDA/Gross Interest) (X)	11.1	13.4	9.0	7.7
Liquidity and Cashflows				
Current ratio excluding CMLTD (X)	0.7	0.8	0.4	0.3
Net Cash Cycle (Inventory Days + Receivable Days - Payable	3	-8	0	-13
Capital Structure (Total Debt/Total Debt+Equity)	53%	61%	49%	35%

Rating Scale

Credit Rating Scale & Definitions

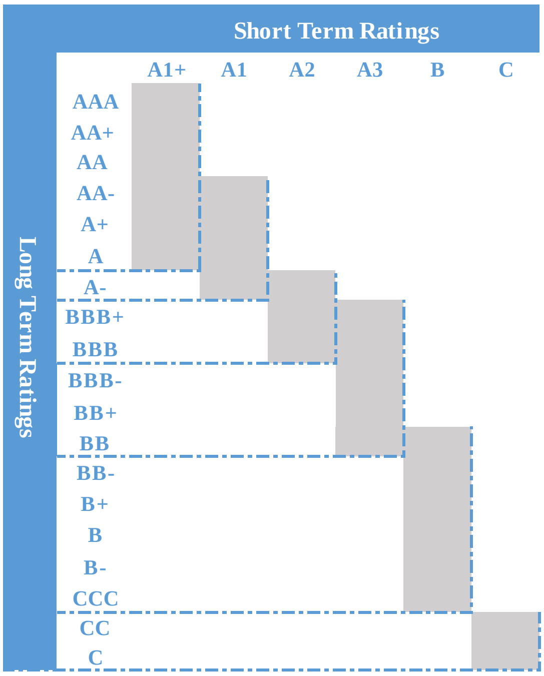
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.



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.

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