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
29-Jun-2020	AA-	A1	Positive	Maintain	-
08-Nov-2019	AA-	A1	Positive	Maintain	-
10-May-2019	AA-	A1	Positive	Maintain	-
08-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	-
30-Apr-2015	AA-	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings incorporate the robust business profile of the company, represented by its leading market share of ~36% with ~60 million cellular subscribers as at Dec’19 and formidable sponsor support. Optimizing on its exclusive brand "Jazz", the company commands solid volumes and strong margins. Additionally , the company is pursuing digitalization as a long term strategy and vision. Overall market dimensions remained positive in CY19 with respect to mobile data services, as penetration level in 3G/4G subscribers stood at ~35% as at Dec’19. Despite re-imposition of tax on mobile services (May'19 onwards), revenue recorded a sanguine growth in CY19. The recent outbreak of global pandemic, Covid-19, has impacted all economic sectors of the country at different levels. After initial minor impact ,Telecom sector, is back on growth track with data leading the way. The company's financial risk profile exhibits a strong outlook demonstrated by eased working capital strategies, comfortable coverages and moderate leveraging (Dec'19). Notable CAPEX is incurred by the company on a periodic and need basis, owing to the nature of the business. Debt profile majorly comprises long term borrowings, including foreign currency exposure. The partial payment for renewal of 2G license USD~270mln under protest till June 2020 (total payment demand by PTA is USD~450mln) necessitated additional external capital dependence. Total on-balance sheet debt level, however, continued to align with the previous trend, as some portion of the previous debt book retired in CY19.

The ratings are dependent upon the sustenance of robust revenue growth and profitability. Positive outlook captures the leading market position of the company and its strong performance indicators. As capital structure becomes leveraged, maintenance of sound financial discipline is imperative to uphold the positive outlook.

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-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Mobile Telecom(May-19)
Rating Analysts	Shazia Afzal | shazia.afzal@pacra.com | +92-42-35869504

Profile

Legal Structure Incorporated in 1990, Pakistan Mobile Communications Limited ("the company") is a public unlisted company. The head office of the company is in Islamabad.

Background PMCL, an unlisted public limited company, was incorporated in Pakistan in December 1990, and commenced operations in August 1994. PMCL was initially also rated by international rating agencies due to its foreign debt exposure.

Operations 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. The company's market share at Dec'19 stood at ~37% with approx. 60 mln cellular subscribers.

Ownership

Ownership Structure VEON owns 85% share of the company while the remaining ~15% stake is held by Warid's Sponsor - Dhabi Group.

Stability Ownership structure is expected to remain stable with clear representation on the governance side.

Business Acumen VEON offers a wide range of wireless, fixed and broadband services to approximately 212mln customers in 10 countries. The group (formerly Vimplecom) has rebranded to VEON through revitalizing its business operations from telecom to wider technology platforms in order to penetrate in diversified streams.

Financial Strength During CY19, the parent company's net profit was recorded at USD 683mln. Total revenue of the group during CY19 clocked in at USD 8,864mln (CY18: USD 9,086mln).

Governance

Board Structure PMCL's Board of Directors comprises seven members including three executive directors – Chief Executive Officer, Chief Financial Officer and Company Secretary. Post-merger, His Highness Sheikh Nahayan Mabarak Al Nahayan is been appointed as the new Chairman of the Board.

Members' Profile The board comprises highly qualified and experienced professionals holding senior positions in the group companies.

Board Effectiveness PMCL's Board of Directors comprises seven members including three executive directors – Chief Executive Officer, Chief Financial Officer and Company Secretary. Post-merger, His Highness Sheikh Nahayan Mabarak Al Nahayan was appointed as the new Chairman of the Board.

Financial Transparency The Auditors of the company, A.F.Ferguson & Co. expressed an unqualified opinion on the company's financial statements for the year ended December 31, 2019. The internal audit function of the company is in-house and reports directly to the board.

Management

Organizational Structure PMCL has a well-defined organizational structure and different operational activities are properly segregated and managed through different departments. The department heads report to the CEO & respective heads at GTH and Veon.

Management Team Mr. Aamir Ibrahim - Ex-CCO and Deputy CEO of Jazz has been appointed as the CEO of the merged entity. He has over two decades experience in blue chip companies across various countries and industries, but majorly of telecom sector.

Effectiveness The top management possess quality education from distinguished educational institutions both local and international. As well as both local and foreign experience. In PMCL's reporting structure, chief holds the senior most position followed by the VP ,Director/Senior Manager and then the manager and Associates.

MIS The company is using Oracle based ERP system (different modules) which is fully integrated amongst all back-end departments of the company.

Control Environment Report generation has been optimized to bring efficiency. The management of PMCL reports at the Group level on a monthly basis via presentation on performance and key KPIs.

Business Risk

Industry Dynamics The country's total number of cellular subscribers reached to 165 million users by Dec-19 (penetration of ~77% of the total market) while 3G/4G subscribers reached to 76 million users (penetration of 35%). The rate of growth in 3G/4G subscribers has been impressive in the last few years.

Relative Position The company relishes on a share of ~36% in market cellular subscribers followed by Telenor which has a 28% market share , demonstrating a strong foothold in the segment, specially growing in data. It also has the highest number of 3G/ 4G subscribers (28mln subscribers).

Revenues During CY19, PMCL's revenue clocked at PKR 197,481mln (CY18: 181,722 mln). Growth in revenue remained at 9% . In terms of ARPUs, average voice ARPU recorded at PKR 115 per user in CY19 with ~7% decrease on YoY basis (Dec18: PKR 123), average data ARPUs recorded at PKR~127 per user with 27% growth on YoY basis (Dec'18: PKR 100). The outbreak of COVID-19 pandemic resulting in countrywide lockdown has heightened the usage of 3G/4G technology which is expected to reap benefits to the company in CY20.

Margins Improved sales translated into improved profit margins, Net profit margin of the company increased to ~17% during CY19 (CY18: 9%).

Sustainability Jazz successfully tested out the fifth generation of mobile technology at the Jazz Digital Headquarters in Islamabad in January 2020. Going forward, the company, would continue its efforts to further strengthen its market position as the leading cellular provider. Focus would remain towards data monetization to improve profitability margins. Furthermore, PMCL, using the platform of Mobilink Microfinance Bank, an associate entity, intends to establish a strong digital platform.

Financial Risk

Working Capital The business of the Company is cash-centric, as is witnessed from an EBITDA to Sales ratio of 51% (CY18: 48%). Healthier EBITDA would enable the Company in meeting the remaining 2G license renewal fees (paid payment of USD 270mln) with ease. This fee has been made under protest and the remaining is contingent upon high court's order.

Coverages Company has incurred PKR~33bln of capex which stands at 17% of revenue. The Company's Debt and Interest coverage remained strong On backdrop of strong FCFO.

Capitalization The company's debt burden is skewed towards long term borrowings. Despite a sizable quantum of Long Term Debts on the book, the Company's formidable Equity base of PKR 136bln (CY18: PKR 126bln) forms a relatively good capital structure (Total Borrowings/Borrowings plus Equity), i.e.,~34% as on Dec'19 (Dec'18:~34%).

The Pakistan Credit Rating Agency

Financial Summary
PKR mln

Pakistan Mobile Communications Limited		Dec-19	Dec-18	Dec-17
Communcation		12M	12M	12M
A. CAPITAL STRUCTURE				
1	Share Capital	48,019	48,019	48,019
2	Shareholder's Equity	136,426	125,779	97,330
	a. Total Borrowings/(Total Borrowings + Equity)	34%	34%	49%
B. BUSINESS ANALYSIS				
1	Sales	197,481	181,722	160,679
	a. Sale Growth	8.7%	13.1%	5.9%
	b. Revenue to Equity	1.4	1.4	1.7
2	Profit or (loss) before interest and tax	64,212	49,731	36,122
3	Net Income or (Loss)	33,984	16,774	12,783
	c. Net profit Margin	17.2%	9.2%	8.0%
	d. Return on Equity	25%	13%	13%
	e. Current Ratio	0.1	0.2	0.1
C. CASH FLOW POSITION				
1	Earnings before Interest, Tax, Depreciation and Amortization (EBITDA)	100,074	86,811	74,096
	a. Cash Conversion Efficiency(EBITDA/Sales)	51%	48%	46%
2	Free Cash Flow from Operations (FCFO)	67,296	62,887	48,831
	b. Cash Conversion Efficiency (FCFO/Sales)	34%	35%	30%

Credit Rating Scale & Definitions

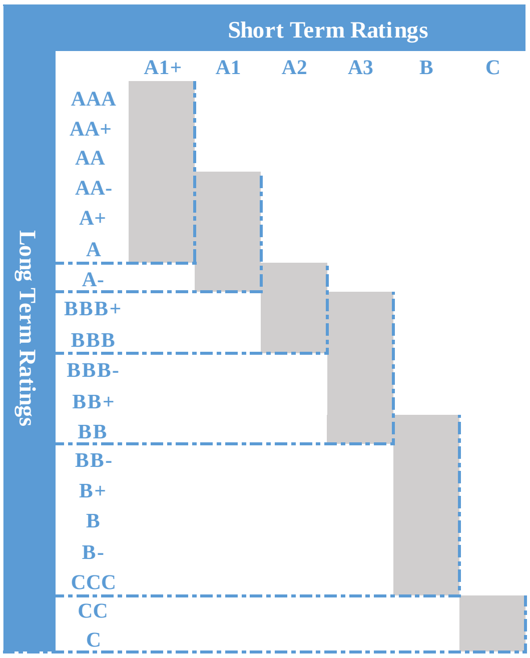
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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