



The Pakistan Credit Rating Agency Limited

Rating Report

Nayatel (Pvt.) Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
05-Sep-2019	A	A1	Stable	Maintain	-
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. Moreover, it has expanded its presence in Faisalabad and Peshawar. 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, wherein monthly breakeven EBITDA has been achieved since Nov'18. It has commenced operations in Peshawar since 2HCY18. Growth plans reflect low niche penetration strategy into smaller 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. However, in the current interest rate environment, coverages adequate. 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	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19)
Related Research	Sector Study Mobile Telecom(May-19)
Rating Analysts	Muhammad Usman muhammad.usman@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 (MBL), in 2004.

Background The company was incorporated under the Companies Ordinance, 1984 (now the 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. MBL, the parent company of Nayatel, was formed by Micronet Group in December 2001, with the sole aim of rolling out the first ever broadband services and solutions in Pakistan. The Micronet Group consists of professionals who have been at the forefront of the Internet wave when it was introduced in Pakistan, in the mid-nineties.

Operations Nayatel specializes in triple play service (telephony, cable TV and data) on the fiber to the home (FTTH) network. The company has operations in Islamabad, Rawalpindi, Faisalabad and recently in Peshawar too. It 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 MBL. MBL's ownership comprises seven individuals of which Mr. Rashid Khan and Mr. Ashraf Qazi have the highest stake of ~35% and ~30% respectively, followed by Mr. Mubashir Malik (~16%) and Mr. Alamgir Khan (~11%). The remaining three shareholders have less than ~5% share.

Stability The company has a stable ownership structure comprising a single holding company owned by a group of individuals.

Business Acumen Nayatel's business model was conceived by MBL's founding members; Mr. Wahaj us Siraj, Mr. Aqeel Khurshid & Khawaja Saad Saleem, all whom are experienced professionals, with an engineering background. They remain closely connected friends. Moreover, Mr. 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 good, as the sponsoring company is owned by individuals possessing good financial profiles.

Governance

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

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, support the management in terms of strategic guidance. Albeit, no formal board committee exists.

Financial Transparency Grant Thornton & Co. Chartered Accountants are the external auditors of the company. A separate internal audit department is in place.

Management

Organizational Structure Nayatel has a well-defined organizational structure. Different operational activities are properly segregated and managed through various departments. All department heads, report to the Chief Executive Officer (CEO), while the technical departments and operational departments report to the Chief Technology Officer and Chief Operating Officer respectively.

Management Team Mr. Wahaj Siraj is the CEO and co-founder of Nayatel. He has vast experience in the internet and telecom industry. He has also worked with the Government of Pakistan at policy formulation level. He is assisted by an experienced management team to run the business. Khawaja Saad Saleem, COO, is the brain behind FTTH network design and its deployment in areas of the company's network. Mr. Aqeel Khurshid, CTO, possesses a wealth of technical knowledge and experience in the Telecom Sector.

Effectiveness The company has a sound Supply Chain Management process for procurement and sales, requiring approval from the CEO, COO, CTO and/or 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 basis, to discuss the company's financial position and future strategy.

Control Environment The company has a sound internal control environment. 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 The broadband industry (other than cellular internet, i.e., 3G and 4G) is classified based on the technology type, including DSL, wireless services and FTTH internet services. There are a total of ~147 thousand FTTH active subscribers in the country. Lately, there has been a shift in the preference of the consumers, requiring higher speeds and data limits pushing inclination towards FTTH. The FTTH technology is the best bet to adequately meet the ever changing requirements. As awareness relating to the capability of the fiber optical internet will increase, it will have a positive impact on the demand in this segment of the industry. With a handful of internet providers operating in the country coupled with high barriers to entry, there is room for each player to expand its operations.

Relative Position Nayatel is the market leader in the domain of FTTH internet services with a 43% market share, with respect to the number of subscribers, in the country. The company operates under the licenses issued by PTA and PEMRA. Nayatel has obtained 10 licenses altogether, comprising; five loop licenses, four cable TV/IPTV licenses and one CVAS license.

Revenues During CY18, the company's turnover clocked at PKR~2.8bln (CY17: PKR~2.4bln) registering an ~18% growth in the topline. The company has been successful in improving its topline at a steady pace in the recent years. During 3MCY19, the company posted a revenue of PKR~758mln (3MCY18: PKR~675mln) with a ~12% period on period increase. The company is now reaping fruits from its investment in Faisalabad. The operations in Peshawar are still at an infancy stage, and will take time to make a good contribution to the topline of Nayatel.

Margins Gross profit margins clocked in at ~36% for 3MCY19 (CY18: ~36%, CY17: ~32%). The trend of the net profit margins has been less linear. After incurring a net loss in CY17 (-2.1%), the company performed remarkably well in CY18 with net profit margin reaching to ~22%. The company's focal point of strategy lies in controlling its finance costs in order to keep its bottomline margins intact.

Sustainability Topline is expected to pick up in the coming periods, as a result of two fold growth, i.e., (i) addition of new customers and (ii) incremental revenue per user. Moreover, geographical expansions into new cities fortifies the company's sustainable position in the FTTH market.

Financial Risk

Working Capital A gradual improvement in the working capital management is noted. During 1QCY19, the average inventory days stood at ~26 days (CY18: ~27 days, CY17: ~29 days). Moreover, the average debtor days have reduced to 40 days (CY18: 43 days, CY17: 43 days), furthering improving the working capital mechanism of the company. On the other hand, the trade payable days have decreased to 36 days. (CY18: 41 days, CY17: 42 days). In accumulation, Nayatel's gross working capital cycle has improved to 66 days (CY18: 70 days, CY17: 72 days). The net working capital cycle, clocking at 30 days, has remained consistent with the prior years (CY18: 29 days, CY17: 30 days).

Coverages The free cash flows (FCFO) during CY18 clocked at PKR~1,016mln, in line with the higher profits, substantially increasing from PKR~534mln in CY17. FCFO coverage to debt obligations (finance cost, CMLTD and uncovered short term borrowing) stood at 1.3x in CY18 (CY17: 1.2x). The company follows IAS-23 in application of its finance costs, i.e., capitalizes directly attributable finance costs in the value of qualifying assets. In totality, coverages fall under a pressured zone.

Capitalization The company is leveraged with the debt to equity ratio (net of Revaluation Surplus) of ~46% as at 1QCY19 (CY18: ~46%, CY17: ~48%). The borrowings comprise mainly long term debt and its current maturities (98% of total debt). These long term borrowings stood at PKR~1.75bln (CY18: PKR~1.76bln, CY17: PKR~1.46bln). The current maturity has been part of a rising trend by reaching PKR~740mln (CY18: PKR~675mln, CY17: PKR~438mln). Short Term Borrowings have also risen to PKR~57mln (CY18: PKR~33mln, CY17: PKR~59mln). As at end of 1QCY19, the company had obtained 12 lines from seven different banks.



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Financial Summary

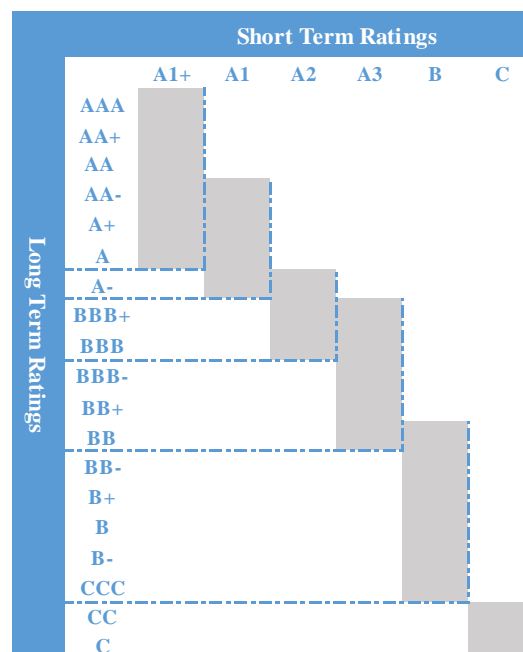
PKR mln

Nayatel (Pvt.) Ltd Communication	Mar-19 3M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Non-Current Assets	6,327	6,214	5,481	2,936
2 Investments	-	-	-	-
3 Related Party Exposure	22	22	22	45
4 Current Assets	1,365	1,271	1,009	811
a Inventories	212	225	196	184
b Trade Receivables	322	342	327	236
5 Total Assets	7,714	7,507	6,512	3,792
6 Current Liabilities	357	297	375	195
a Trade Payables	332	274	361	192
7 Borrowings	2,564	2,485	1,993	1,025
8 Related Party Exposure	22	22	22	22
9 Non-Current Liabilities	725	736	776	356
10 Net Assets	4,046	3,968	3,346	2,194
11 Shareholders' Equity	4,046	3,968	3,346	2,194
B INCOME STATEMENT				
1 Sales	759	2,854	2,405	2,043
a Cost of Good Sold	(484)	(1,828)	(1,648)	(1,313)
2 Gross Profit	275	1,026	757	729
a Operating Expenses	(116)	(483)	(451)	(315)
3 Operating Profit	159	544	306	414
a Non Operating Income or (Expense)	8	39	(186)	47
4 Profit or (Loss) before Interest and Tax	167	583	121	461
a Total Finance Cost	(69)	(88)	(12)	(51)
b Taxation	(20)	127	(159)	(143)
6 Net Income Or (Loss)	78	622	(50)	267
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	151	1,016	534	471
b Net Cash from Operating Activities before Working Capital Changes	86	934	533	417
c Changes in Working Capital	(197)	(121)	42	32
1 Net Cash provided by Operating Activities	(111)	814	575	449
2 Net Cash (Used in) or Available From Investing Activities	(221)	(1,239)	(1,497)	(1,263)
3 Net Cash (Used in) or Available From Financing Activities	373	483	943	825
4 Net Cash generated or (Used) during the period	41	58	21	11
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	6.4%	18.7%	17.7%	16.3%
b Gross Profit Margin	36.2%	36.0%	31.5%	35.7%
c Net Profit Margin	10.3%	21.8%	-2.1%	13.1%
d Cash Conversion Efficiency (EBITDA/Sales)	37.5%	41.4%	32.4%	36.4%
e Return on Equity (ROE)	7.8%	17.0%	-1.8%	13.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	66	70	72	108
b Net Working Capital (Average Days)	30	29	30	69
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.8	4.3	2.7	4.2
3 Coverages				
a EBITDA / Finance Cost	4.1	13.4	62.5	14.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.6	1.3	1.2	2.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	7.7	2.6	3.7	2.2
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	38.8%	38.5%	37.3%	31.8%
b Interest or Markup Payable (Days)	33.6	93.3	411.0	22.9
c Average Borrowing Rate	10.9%	3.9%	0.8%	7.7%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
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.		
BBB			
BBB-			
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.		
BB			
BB-			
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.		
B			
B-			
CCC	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.		
CC			
C			
D	Obligations are currently in default.		



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 surveil the opinion due to lack of requisite information.	Harmonization A change in rating due to revision in applicable methodology or underlying scale.
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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

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- (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

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- (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.
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- (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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