The Pakistan Credit Rating Agency Limited

Rating Report

Mobile Sales and Distribution (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	BBB+	A2	Stable	Maintain	-
18-Jan-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings incorporate strong foothold of the company in the cellular distribution market. Optimizing on an extensive network of dealers, the company marks its presence as one of the four leading mobile distribution networks of Pakistan. The company functions exclusively with Samsung for distribution services across the country alongside very small businesses with Motorola and Meizu. This enables the company to relish on exclusivity benefits from Samsung, though this also poses a risk of dependence on sole principal. Management, being cognizant of the situation is embarking on several initiatives to mitigate the risk. Room for growth in legal import channel is expected to increase through introduction of DIRBS system. Price hike due to devaluation of local currency is expected to impact the demand of mobile phones negatively. Operating with a status of Private Limited Entity, the company's governance framework indicates room for improvement in terms of independent oversight and effective management. The understanding among the sponsors, although is tacit, it is enriched by social bond. Financial risk profile is reflected by sound business volumes and sanguine margins. With no long term debt on the books, capital structure and coverages remained largely comfortable. Working capital strategy reflected reliance on short term borrowing, wherein which the company is expecting efficiency.

The ratings are dependent on the company’s ability to uphold its strong market position alongside sustaining profitability margins. Improvement in governance structure and revenue diversification remain imperative.

Disclosure	
Name of Rated Entity	Mobile Sales and Distribution (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 | Mobile Phone and Allied Products(Jun-19)
Rating Analysts	Muhammad Nadeem Sheikh | nadeem.sheikh@pacra.com | +92-42-35869504

Profile

Legal Structure Mobile Sales and Distribution (Private) Limited (hereinafter referred to as ‘‘the company’’ or ‘‘MSD’’) was incorporated in 2012 under the Companies Ordinance, 1984 (now “Companies Act, 2017”) as a Private Limited Company.

Background The company was initially established in 2012 by Mr. Latif Hakeem and Mr. Asghar Khan with 85 dealers and only 1 after sales service center. The company grew over the period with tremendous pace and in 2018 has more than 1,100 dealers and 16 after sales service centres.

Operations The primary business of the Company is the import and sale of mobile handsets, allied products and render after sales-services. MSD sells its products to both individual customers through dealers and to the corporate customers. The company is an authorized distributor of Samsung alongside small businesses with Motorola and Meizu.

Ownership

Ownership Structure Ownership structure vests with four shareholders with each shareholder having equal stake in the company (25%). Mr. Latif Hakeem and Mr. Shakir Ullah are brothers and Mr. Asghar Khan and Mr. Muhamamd Umer are similarly related to each other.

Stability With no change since inception, ownership structure is expected to remain stable.

Business Acumen All sponsors of the company were involved in the same business. Before the establishment of their own company, they worked with Mobile Zone (Private) Limited. Mobile Zone was the Pakistan’s leading importer and distributor of mobile phones. Business acumen of the sponsors is, therefore, considered good.

Financial Strength Apart from MSD, sponsors have strategic stake in other companies too, which includes SmartZone - for electronic appliances and MSD Fizco based in Dubai.

Governance

Board Structure Board of Directors consists four members - all sponsors. Mr. Latif Hakeem is the Chairman of the Board. The company has added two non-executive directors on its board since the last rating review. With no independent director, governance structure represents a need for improvement.

Members’ Profile The Board members are professionals with experiences of managing business affairs in related sector. Mr. Latif Hakeem - the Chairman, has experience of ~20 years and is involved in strategic decision making. Before establishing his own business Mr. Latif Hakeem had worked with Mobile Zone. He is associated with the board since inception of the company.

Board Effectiveness No formal board committees are in place. Board committees enhance effectiveness in oversight of the business.

Financial Transparency An Internal Audit department reporting to the board of directors is in place, which closely monitors the policies governing the operational procedures and implementation thereof. The External Auditor of the company is M/s EY Ford Rhodes, Chartered Accountants, one of the big four firms.

Management

Organizational Structure The organizational structure of the company is divided into various functional departments and all heads report to Chief Executive Officer. Different department heads reporting directly to the CEO include (i) Hr & Admin Head, (ii) Product Manager, (iii) Head of Finance (v) General Manager Business Development (vi) Head of Customer Service (vii) Manager Management Information System and others. Segregation of inter-department roles is, however, lacking.

Management Team Management comprises qualified and experienced professionals. Mr. Asghar Khan, the CEO of the company has an overall experience of over ~20 years. The top management is supported by a team of professionals working under various sub-divisions to ensure smooth reporting.

Effectiveness The company has Executive Committee in place which consists of all department heads and directors. Considering the nature of the business, this committee meets every month to discuss recent developments, challenges and future plans.

MIS The company has SAP B1 consisting of 11 modules. It was implemented in Jan-18 before which the company was using an internally generated software. SAP was implemented by Abacus Consulting.

Control Environment The Corporate structure of the company is diverged into various departments. Overall management aptitude is positive, but considering the pace of growth in business volumes, more formal corporate control and policy framework needs to be in place to cope up with the growth in a smooth and effective manner.

Business Risk

Industry Dynamics Pakistan has been one of the fastest growing cellular markets on the globe. The country’s teledensity increased from ~6.3% in FY04 to a high of ~76.76% in May-2019. Smartphone penetration in total mobile phone market is growing but is still low which creates an opportunity for the smart phone manufacturers as well as its distributors. The recent imposition of 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. However, at the same time, rapid devaluation of currency against USD has amplified the prices of imported phones, thus gradually impacting the demand, specially of high-end range mobile phones. Additionally, discontinuation of google business with Huawei, due to US-China trade war is expected to change market share mix amongst the major brands, going forward.

Relative Position The company is one of the leading four distributors of mobile phones in Pakistan. Currently, the company is working with a single top niche brand i.e Samsung. A large room in the market for legal importers is being foreseen through introduction of DIRBS system in Pakistan. On the contrary, due to future uncertainty of Huawei in the market, competition in the Samsung distribution market is instigated, which may affect the company's market share, going forward.

Revenues During 9MFY19, the company’s topline clocked in at PKR~8,421 million (FY18: PKR~13,594 million) depicting an annualized decrease of 19%. Owing to increase in prices of mobile phones on the backdrop of local currency devaluation, sale of Samsung's high end premium products has decreased.

Margins Gross profit margin for 9MFY19 has remained relatively stable at ~22% (FY18: ~21%). The company is operating in a highly volatile environment, as launch of new products majorly impact the per unit price of previous model. Increased prices of mobile phones due to rupee devaluation has little bearing on the company's margins as almost all cost is passed on to end consumer or borne by the principal.

Sustainability Overall demand for mobile phones is expected to slow down owing to deteriorated economic condition and steep devaluation of local currency . Recent implementation of DIRBS will reduce the imports of mobile phones through grey channels. Hence, it provides good opportunity to existing distributors to increase their revenues. Further, the management is keen on mitigating risk of dependence on one principal, as a result of which diversity in revenue stream is in the pipeline.

Financial Risk

Working Capital The company's working capital requirement emanates majorly from financing receivables from dealers for which the company relies on both internal cash flows as well as short term borrowings. Average inventory days slightly increased to ~21 days at the end of 9MFY19 (FY18: ~20 days). However, sharp increase in trade receivable days was witnessed in 9MFY19 as reflected in ~60 days cycle (FY18: ~44 days). Thereby, net working capital days hiked to ~77 days during 9MFY19 (FY18: ~59 days). SBP's requirement to deposit 100% margin before opening of Letter of Credit has elevated the working capital management of all the businesses transacting through LC arrangements. Going forward, the management strategizes on cutting credit period for dealers to reduce working capital needs and ultimately reliance on short term borrowings.

Coverages Free cash flow from operations (FCFO) clocked in at PKR~526 million in 9MFY19 (FY18: PKR~898 million). Reduced profitability translated into reduced FCFO. Core coverage sharply decreased to 3.7x during 9MFY19 (FY18: 9.1x) owing to reduced cash flows and increased interest cost. Cautious management approach is necessitated.

Capitalization Total debt as at End-March 19 stood at PKR~1,702 million (FY18: PKR~1,583 million). Comfort is drawn from nil long term liabilities. Gearing ratio of the company hovered at ~32% at End-March-19 (FY18: ~33%). Management is focused on reducing short term borrowings through better working capital management strategies.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

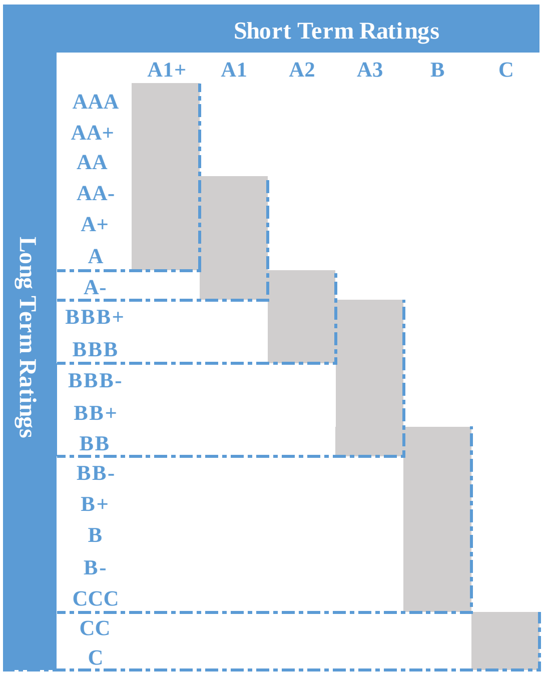
Mobile Sales & Distribution (Pvt.) Limited Communication	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	1,489	1,293	783	564
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	4,383	4,322	3,325	3,801
a Inventories	*496*	*800*	*757*	*860*
b Trade Receivables	*1,827*	*1,886*	*1,450*	*1,225*
5 Total Assets	5,873	5,616	4,108	4,365
6 Current Liabilities	501	759	729	2,167
a Trade Payables	*86*	*191*	*177*	*1,702*
7 Borrowings	1,702	1,583	1,447	719
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	3,669	3,273	1,932	1,480
11 Shareholders' Equity	3,669	3,273	1,932	1,480
B INCOME STATEMENT				
1 Sales	8,421	13,886	12,562	15,074
a Cost of Good Sold	*(6,578)*	*(11,030)*	*(10,448)*	*(12,997)*
2 Gross Porfit	1,843	2,856	2,114	2,077
a Operating Expenses	(893)	(1,303)	(1,035)	(816)
3 Operating Profit	949	1,554	1,079	1,261
a Non Operating Income	*0*	*1*	*(7)*	*1*
4 Profit or (Loss) before Interest and Tax	949	1,555	1,073	1,262
a Total Finance Cost	*(140)*	*(98)*	*(60)*	*9*
b Taxation	*(344)*	*(663)*	*(580)*	*(749)*
6 Net Income Or (Loss)	465	794	432	522
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*526*	*898*	*538*	*520*
b Net Cash from Operating Activities before Working Capital Changes	*385*	*815*	*486*	*511*
c Changes in Working Capital	*(85)*	*(974)*	*(811)*	*(84)*
1 Net Cash provided by Operating Activities	300	(159)	(325)	427
2 Net Cash (Used in) or Available From Investing Activities	(170)	(68)	(235)	(186)
3 Net Cash (Used in) or Available From Financing Activities	(69)	205	-	-
4 Net Cash generated or (Used) during the period	61	(21)	(560)	241
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-19.1%	10.5%	-16.7%	65.2%
b Gross Profit Margin	21.9%	20.6%	16.8%	13.8%
c Net Profit Margin	5.5%	5.7%	3.4%	3.5%
d Cash Conversion Efficiency (EBITDA/Sales)	10.3%	11.4%	8.8%	8.5%
e Return on Equity (ROE)	17.8%	30.5%	25.3%	35.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	81	64	62	30
b Net Working Capital (Average Days)	77	59	35	-12
c Current Ratio (Total Current Assets/Total Current Liabilities)	8.7	5.7	4.6	1.8
3 Coverages				
a EBITDA / Finance Cost	6.2	16.2	77.1	-164.6
b FCFO / Finance Cost+CMLTB+Excess STB	3.7	9.1	37.4	-66.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	1.4	1.4
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	31.7%	32.6%	42.8%	32.7%
b Interest or Markup Payable (Days)	1.0	1.0	0.5	0.0
c Average Borrowing Rate	11.4%	6.5%	1.3%	-1.1%

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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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