

VIS RATING METHODOLOGY

TELECOMMUNICATION

VIS Credit Rating Company Limited (VIS) assesses the credit quality of telecom operators including mobile operators by analyzing their business and financial risks. When scrutinizing business risks, VIS considers factors such as regulatory environment, ability of the operator to improve/maintain revenue as well as subscriber market share, upgrade network infrastructure to withstand competition and adapt to new technologies, and manage average revenue per user (ARPU) levels and subscriber churn. When assessing financial risks, VIS considers the present and future financial position of the operator, financial flexibility to refinance or defer capital expenditure (capex), and sponsors' ability to inject funds. The ratings are forward-looking, with special attention on the outlook for such services within the boundaries of regulatory considerations, sponsor profiles, and the geographical market for telecom operators.

The advent of high speed fiber optics cables, broadband satellite and wireless technologies circumventing the global data transmission for business, entertainment, educational, vocational and government use has been growing in double digit rates over the years. The telecommunications field has thus assimilated into the business, entertainment and policy making environment becoming an integral part of it.

The distinct segments in which the role of Telecommunications is embedded are three as follows:

- 1. The data generators:** the thousands of search engines and data hosting websites on the worldwide web (Internet) belonging to businesses (commercial, entertainment or social services), research platforms and governments. Prominent examples here include google, facebook, chrome, Netflix, and web portals of government and non government agencies.
- 2. The data processors:** are the end users, which may be in any of the above categories and create their own data at one or multiple locations and then consolidate it, for gainful use as determined by them, at their processing centers. Some major examples are banks and financial institutions local or international, corporates particularly geographically diversified, media companies, multilaterals, international financial and social agencies and governments. The international payment solution/settlement companies such as Visa, Master Card, Paypal etc fall into this category.
- 3. The Highway provider:** these entities are the backbone of the Telecommunications system and provide the medium for transmission of the data from one location to another which could be within the city, country, continent or the whole world. Some examples of it are entities which own and operate sea fiber optic cables, land fiber optic cables, data handling satellites and data storage facilities.

While the broader methodology of industrial corporates applies to entities in the telecom sector, this methodology outlines the criteria used by VIS to evaluate and rate telecom operators some of which over time have diversified into some or more of the above three segments in addition to cellular services. VIS gives due importance to both the business and financial risk profiles of operators in its rating process.

Business Risk

In assessing the business risk profiles of telecom operators, VIS first evaluates risk factors that are common to the entire industry and then analyses the specific issues that define an individual operator's market position both in terms of footprint and tele-density. Given that the telecom industry in Pakistan continues to evolve, risk factors are many, some of which are important from a credit perspective.

Regulatory Risk

VIS believes that, as with other private sector infrastructure projects in the country, the risk profile of telecom operators has also been strongly influenced by the regulatory environment governing their rights and obligations. Changes in the regulations and their impact on the rated companies' businesses are duly factored in. Presence of an independent regulator and the substantial clearing up of the regulatory landscape augur well for the industry.

Technology Risk

Mobile telephone technology has rapidly evolved in the past few years. The introduction of Long-Term Evolution (LTE) or 4G technology at lower cost led to customers switching to LTE/4G. The key challenge for an operator is the ability to upgrade the network to match the features being offered by competitors and remain cost-effective. Networks with cheaper and easier migration path towards higher versions such as 5G will be at a significant advantage. The deployment of current technologies in telecom sector is important from the rating perspective. VIS also takes into account the bouquet of additional telecom services these companies provide and their investments in allied and related fields as identified above particularly in Fintech areas.

Market Position

The competitive scenario plays a very important role in defining the characteristics of any industry. Thus, entry of new operators, pace of expansion of existing operators, and the consequent impact on tariffs, net subscriber addition shares, customer acquisition cost, and the industry's ARPU are factored in while assessing the business risk profiles of telecom operators.

Since industry-wide risks are common to all telecom operators, VIS analyses the operators' market position based on services being offered, performance track record, subscriber and revenue market share in their areas of operations, and marketing strategies vis-à-vis competitors. An operator's ability to maintain momentum in subscriber additions and garner a higher share of the net subscriber additions reflects its overall competitive position. The targeted consumer mix, divided into prepaid and postpaid customers, is an indicator of the operator's likely usage levels and average airtime tariffs. The distribution and concentration of revenues and cost efficiencies in cellular and supplementary business would also be considered.

An operator's business risk profile would also be influenced by its ability to manage ARPU levels by having the right postpaid-prepaid mix; as well as by its ability to charge slightly higher tariffs, while maintaining market share on the back of better coverage and service, and superior churn-management strategies. An operator's overall footprint is also considered as larger operators benefit from lower operating costs per subscriber due to economies of scale. Also, a strong presence in at least one service area supports market position by mitigating the impact of a delayed subscriber build-up in other circles.

VIS holds the view that a company's ability to continuously attract new customers, mitigate subscriber churn through healthy additions, manage ARPU levels, and organize operations so as to derive economies of scale from a growing customer base would have a critical impact on its credit quality.

Financial Risk

VIS analyses telecom operators' capital structure, including levels of equity and debt financing. The key financial parameters that VIS assesses include debt service coverage and FFO to debt ratios. VIS analyses the projected financials with reference to an operator's future plans, funding requirement for expansions, and coverage and profitability ratios.

Sponsors Financial Strength and Cash Flow Adequacy

VIS analyzes sponsors' financial strength and their ability to inject need-based funds into the business. In view of the relatively large ongoing operational capex requirements along with high competitive nature of the market bringing cyclicality in margins, well capitalized sponsors with sound access to capital market are considered well placed in the telecom environment. In several cases, debt-financing facilities are contingent on specified performance and capital structure requirements and may involve additional equity injection by the sponsors. VIS specifically assesses sponsors' ability to address all performance and capital structure covenants and maintain a steady drawdown from specified debt facilities. VIS believes the manner in which a sponsor intends to fund initial losses and the contingencies available, in the event that the gestation period is longer than anticipated, would be critical consideration. Funding requirements of group companies and importance of the telecom venture to the sponsors are also assessed.

VIS also analyzes the sponsors' overall flexibility with regard to deferring capex and delaying the roll-out. VIS thus recognizes the modular nature of telecommunications technology, whereby an operator can delay a part of its capex in case of resource constraints and limited business opportunities.

Management Risk

To analyze the management risk profile of a telecom operator, VIS follows the standard criteria used for all manufacturing companies, which is presented in detail in our publication, Corporate Methodology. Thus, in VIS's opinion, the factors that determine the credit quality for a telecom operator are: ability to maintain/improve revenue market share and operating efficiencies amid competition, ever-changing technological landscape, and regulatory overreach. An operator's existing and future financial position and financial flexibility help determine the rating.

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Rating Scale - Medium to Long-Term**AAA**

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. https://s3-us-west-2.amazonaws.com/backupsqvis/docs/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. https://s3-us-west-2.amazonaws.com/backupsqvis/docs/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

Rating Scale - Short-Term**A-1+**

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. https://s3-us-west-2.amazonaws.com/backupsqvis/docs/private_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.



Faheem Ahmad

President & CEO, VIS Credit Rating Company Limited

Founder, VIS Group

Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA.



Maimoon Rasheed

Director

Maimoon possesses 20+ years experience in financial risk assessment with focus on credit ratings, conventional finance, and general management. He possesses management experience in the fields of financial risk modeling, asset management and brokerage. He has been actively involved in both buy and sell side capital market research. Maimoon's overall experience comprises ratings of entities across a range of sectors including financial – Commercial banks, investment banks, asset management companies, leasing companies, modarabas, securities houses and insurance companies – and corporates in different industries. He obtained his B.S in Applied Geology from Punjab University, Lahore. He also has Masters Degrees in Business Administration with majors in Finance.

Jahangir Kothari Parade (Lady LLOYD Pier)

Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari Parade

National Excellence, International Reach

VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, VIS continues its endeavor to remain an emblem of trust.

VIS Credit Rating Company Limited

Technical Partners Islamic International Rating Agency, Bahrain
JV Partner CRISL, Bangladesh
Member Association of Credit Rating Agencies in Asia

KARACHI

VIS House - 128/C, Jami Commercial Street 14
D. H. A. Phase VII, Karachi - Pakistan

LAHORE

VIS House - 61-A/1, Street # 17
Cavalry Ground, Lahore - Pakistan

Tel: (92-21) 5311861-70 Fax: (92-21) 5311872-73
E-mail: info@vis.com.pk
Website: www.vis.com.pk