



The Pakistan Credit Rating Agency Limited

Rating Report

Dawood Hercules Corporation 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
23-Jun-2023	AA	A1+	Stable	Maintain	-
25-Jun-2022	AA	A1+	Stable	Maintain	-
25-Jun-2021	AA	A1+	Stable	Maintain	-
26-Jun-2020	AA	A1+	Stable	Maintain	-
27-Dec-2019	AA	A1+	Stable	Maintain	-
28-Jun-2019	AA	A1+	Stable	Maintain	-
28-Dec-2018	AA	A1+	Stable	Maintain	-
28-Jun-2018	AA	A1+	Stable	Upgrade	-
30-Dec-2017	AA-	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Over the years, Dawood Hercules Corporation Limited's ("DH Corp" or "the Company") has shown very strong profile as an investment company. The Company holds a diversified investment book mainly through Engro Corporation Limited ('Engro Corp'). DH Corp has a structured oversight process in place for monitoring and making new investments, an important requisite for any investment holding company. The Company has invested in blue chip market securities to mitigate investment related risks. DH Corp is exploring new investment avenues to add to its portfolio. During CY22, the Company through a share swap agreement with Avanceon Ltd., a technology based business, has sold its entire stake in its wholly owned subsidiary, Empiric AI (Pvt.) Ltd., for 5.68% shares in Octopus Digital Ltd., a subsidiary of Avanceon Ltd. Octopus provides operational and maintenance support services to businesses for digitalizing their manufacturing, supply chain and financial workflows. DH Corp continues to receive consistent dividend income from Engro Corp, as the subsidiary's underlying businesses have witnessed substantial growth in many of its business verticals. The Company boasts a very strong financial risk profile owing to strong coverages and significant liquidity showing a robust position. The Company holds short term debt on its balance sheet to fund its equity portfolio. However, leveraging remains strong. Moreover, very strong business acumen of the sponsoring family and strong governance practices provide support to the ratings. The ratings depend on the management's ability to sustain low risk profile and follow prudent investment policy. At the same time, maintaining a strong financial profile and liquidity remains important. Any significant increase in debt and/or prolonged downturn in invested companies will impact the ratings.

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Disclosure

Name of Rated Entity	Dawood Hercules Corporation Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology Rating Modifiers(Jun-22),Methodology Holding Company Rating(Jun-22)
Related Research	Sector Study Holding Company(Aug-22)
Rating Analysts	Faiqa Qamar faiqa.qamar@pacra.com +92-42-35869504



Profile

Background In Apr-86, Dawood Group ('the Group') incorporated Dawood Hercules Chemicals Ltd. In Jan-11, after major restructuring, Dawood Hercules Chemicals Ltd. demerged its fertilizer operations by establishing a wholly owned subsidiary, DH Fertilizers Ltd.; while, transforming the Company as a holding company and changed the name to Dawood Hercules Corporation Ltd. ('DH Corp' or 'the Company'). DH Corp is listed on PSX.

Structural Analysis DH Corp is an investment holding company (HoldCo) of the Group, with prime focus to manage investments in subsidiaries and associates. The Company's investment book comprises substantial holding (~ 37.22%) in Engro Corporation Ltd. ('Engro Corp'). The Group's business portfolio spans across various sectors including fertilizer, PVC, food, power generation, coal mining and LNG storage.

Ownership

Ownership Structure The Group (Dawood Family and associates) holds ~32.66% stake in DH Corp through corporate entities (~30%) and individuals (~2.6%). ~54% stake is held by foreign companies and remaining shares are held by financial institutions, general public and others.

Stability Ownership of the Company is seen as stable as major ownership vests with the sponsors and HoldCo nature of the Company.

Business Acumen The Group is a conglomerate with over three generations of experience. Currently, the Group, through its subsidiary, has interests in various sectors of the economy including fertilizers, foods, power generation, technology, financial services, chemical storage, and petrochemicals. Strong affiliation and technical track record with international JVs have added success of the companies within the Group.

Financial Strength The Group's main HoldCo's are DH Corp and Dawood Lawrencepur Ltd. The Group's main investment in Engro Corp is consolidated in DH Corp. In addition, the Group includes Cyan Ltd. (a listed entity, engaged in making equity investment in companies with high growth potential). DH Corp has a strong consolidated asset base of ~ PKR 766bln with an equity base of ~ PKR 249bln as of CY22, signifying a robust strength. Consolidated revenue stood at ~PKR 357bln during CY22.

Governance

Board Structure The control of the Company vests with the eight-member BoD; which includes five Non-Executive Directors, one Executive Directors and two Independent Directors. The BoD is dominated by the sponsoring family, where majority have long association with the Company.

Members' Profile The BoD is chaired by Mr. Hussain Dawood, the patriarch of Dawood Family. He is a businessman and philanthropist, and chairs many profit and non-profit ventures. All members are seasoned professionals with varied experience that brings diverse range of skills.

Board Effectiveness The BoD has constituted three committees to assist in governing the affairs of the Company; comprise: a) Audit Committee, b) Human Resource & Remuneration Committee (HR&RC), and c) Investment Committee (IC). The committees remain an important medium through which strategic matters of DH Corp and its investments are brought to the BoD. During CY22, the BoD met six times, while, the the Audit Committee met four times, HR&RC met three times and the IC met five times.

Transparency DH Corps' external auditor, A.F. Ferguson & Co., has issued an unqualified opinion on the financial statements for the year ended Dec-22.

Management

Organizational Structure DH Corp functions as an investment holding company. It has instituted a simple organizational structure that is divided across basic functional divisions. The subsidiaries' structure has been given independent operational roles.

Management Team DH Corp's CEO, Mr. M. Shamooin, joined the Company in Oct-18 and has more than 28 years of progressive and varied experience in the financial sector. He has previously served as the CFO of the Company.

Management Effectiveness Key members of the BoD are also present on the BoD's of its investee companies. This helps exercise effective oversight and control. DH Corp generates a standardized quarterly MIS for its BoD members – Dashboard – which provides a structured breakdown of information on predetermined key indicators for the Company as a whole as well as each Group entity, individually.

Control Environment Previously, the Internal Audit Function of DH Corp was outsourced to EY Ford Rhodes Chartered Accountants. Now, the Company has an in-house Internal Audit department headed by Certified Internal Control Auditor (CIA).

Investment Strategy

Investment Decision-Making The Company has three separate teams at Group level for Strategy, Treasury and Equity investments. Strategy team devising new ventures for the Group companies and the Head reports to the CEO. Treasury team handles short-term money market investments. While, equity investment team evaluates opportunities in the equity market, both listed and private. Manager of both teams report to the CEO.

Investment Policy The Company has conservative investment policy as their primary investment is Engro Corp (~ 74% of its total investments as at 1QCY23). Moreover, DH Corp has diversified pool of investment as it is invested in various sectors i.e., fertilizer, chemicals, banks, energy, petroleum sector through its listed equities' portfolio.

Investment Committee Effectiveness The Group investment team liaisons with the rest of the Group companies, and receives updates on their performance regularly. The team then presents them to the BoD on a quarterly basis.

Business Risk

Diversification DH Corp's total long term investment book comprises only one investment i.e., Engro Corp. On the Group level, primarily through Engro Corp, the investments are diversified into various sectors including Food, Fertilizers, Petrochemicals, Energy, Information Technology, Terminal Services and Telecommunication Infrastructure.

Portfolio Assessment The Company's long term investment in listed subsidiary, Engro Corp, and short term investments in listed scrips dominate the portfolio. Engro Corp's standalone revenue comprises consistent dividend and royalty income from its subsidiaries and JVs. During CY22, entire stake in Empiric AI (Pvt.) Ltd. (a wholly owned subsidiary) was sold to Avanceon Ltd. through a share swap arrangement, where DH Corp acquired ~5.68% stake in Octopus Digital Ltd. (a subsidiary of Avanceon Ltd.)

Income Assessment Total investment income of the Company improved (CY22: PKR 6.2bln, CY21: ~PKR 6bln) mainly due to higher dividends from Engro Corp. However, substantial increase in unrealized loss on equity investments was also witnessed (CY22: ~PKR 2.5bln, CY21: ~PKR 386mln). Moreover, increase in finance cost led to lower net income (CY22: ~PKR 3.6bln, CY21:~PKR 3.9bln). Total investment income increased (1QCY23: PKR 810mln, 1QCY22: ~PKR 389mln) due to higher dividends.

Financial Risk

Coverages The Company's total operating cashflows improved (CY22: ~PKR 5.5bln, CY21: ~PKR 4.3bln) along with increased finance cost (CY22: ~PKR 715mln, CY21: ~PKR 143mln). This led to lower interest cover (CY22: 7.7x, CY21: 30.3x) and debt cover (CY22: 7.6x, CY21: 28.1x). As at 1QCY23, the Company's interest (1QCY23: -0.5x, 1QCY22: 3.3x) and debt (1QCY23: -0.5x, 1QCY22: 3.2x) cover was negative due to higher finance cost and reduced cashflows registered by timing difference in dividend inflow.

Capital Structure The Company's leverage ratio increased (CY22: 19.5%, CY21: 17.6%), however, remained low. This was mainly due to lower equity base (due to reduced profits) and increased financing. However, as of 1QCY23, the leveraging ratio improved (1QCY23: 13.2%, 1QCY22: 17.6%) due to reduced borrowings.

Consolidated Position DH Corp has a strong consolidated asset base of ~ PKR 766bln supported by an equity base of ~ PKR 249bln in CY22 signifying a robust strength. Consolidated revenue stood at ~PKR 357bln during CY22 with a consolidated bottom-line of ~PKR 42.9bln (CY21: ~PKR 50.7bln). While, as of 1QCY23, the consolidate asset base was PKR 813bln with an equity of PKR 243bln. Consolidated revenue stood at PKR 104bln with a bottom-line of PKR 8.9bln, during 1QCY23.



The Pakistan Credit Rating Agency Limited

Dawood Hercules Corporation Holding Company	Mar-23	Dec-22	Mar-22	Dec-21	Dec-20
	3M Management	12M Audited	3M Management	12M Audited	12M Audited
A BALANCE SHEET					
1 Investments	8,358	10,971	13,845	13,531	13,851
2 Related Party Investments	23,312	23,312	23,721	23,719	23,597
3 Non-Current Assets	377	458	64	68	95
4 Current Assets	756	191	233	297	1,628
5 Total Assets	32,803	34,931	37,862	37,614	39,172
6 Current Liabilities	1,341	1,510	834	658	706
7 Borrowings	4,157	6,530	6,504	6,506	7,361
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	6	6	6	43	103
10 Net Assets	27,299	26,885	30,517	30,408	31,002
11 Shareholders' Equity	27,299	26,885	30,517	30,408	31,002
B INCOME STATEMENT					
1 Total Investment Income	810	6,222	389	6,013	6,970
a Cost of Investments	(195)	(716)	(144)	(143)	(1,019)
2 Net Investment Income	615	5,506	246	5,869	5,951
a Other Income	42	31	2	9	10
b Operating Expenses	(39)	(257)	(74)	(998)	(1,036)
4 Profit or (Loss) before Interest and Tax	618	5,281	174	4,880	4,924
a Taxation	(204)	(1,588)	(64)	(899)	(1,196)
6 Net Income Or (Loss)	414	3,692	109	3,981	3,728
C CASH FLOW STATEMENT					
a Total Cash Flow	(96)	5,538	464	4,288	4,380
b Net Cash from Operating Activities before Working Capital Changes	(286)	4,934	413	4,135	3,350
c Changes in Working Capital	(53)	65	152	(66)	(23)
1 Net Cash provided by Operating Activities	(338)	5,000	566	4,069	3,327
2 Net Cash (Used in) or Available From Investing Activities	2,716	220	(914)	(5,282)	4,205
3 Net increase (decrease) in long term borrowings	-	-	-	(7,320)	(2,240)
4 Net Cash (Used in) or Available From Financing Activities	4,088	(7,090)	(1)	(11,975)	(6,471)
5 Net Cash generated or (Used) during the period	6,466	(1,870)	(350)	(13,189)	1,062
D RATIO ANALYSIS					
1 Performance					
a Asset Concentration (Market Value of Largest Investment / Market Value c	100.0%	100.0%	100.0%	100.0%	100.0%
b Core Investments / Market Value of Equity Investments	100.0%	100.0%	100.0%	100.0%	100.0%
c Marketable Investments / Total Investments at Market Value	13.4%	18.1%	19.5%	18.5%	8.9%
2 Coverages					
a TCF / Finance Cost	-0.5	7.7	3.3	30.3	4.3
b TCF / Finance Cost + CMLTB	-0.5	7.6	3.2	28.1	4.2
c Loan to Value (Funding / Market Value of Equity Investments)	0.1	0.1	0.1	0.1	0.1
3 Capital Structure (Total Debt/Total Debt+Equity)					
a Leveraging [Funding / (Funding + Shareholders' Equity]	13.2%	19.5%	17.6%	17.6%	19.2%
b (Funding + Off Balance Sheet Exposure) / Shareholders' Equity	15.2%	24.3%	21.3%	21.4%	23.7%

Credit Rating

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
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.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



*The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults, or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):
 a) Broker Entity Rating
 b) Corporate Rating
 c) Debt Instrument Rating
 d) Financial Institution Rating
 e) Holding Company Rating
 f) Independent Power Producer Rating
 g) Microfinance Institution Rating
 h) Non-Banking Finance Companies Rating

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(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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- (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 | Clause 11-(A)(p).
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- (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)

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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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