



The Pakistan Credit Rating Agency Limited

Rating Report

Dawood Hercules Corporation Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2018	AA	A1+	Stable	Maintain	-
28-Jun-2018	AA	A1+	Stable	Upgrade	-
30-Dec-2017	AA-	A1+	Stable	Maintain	-
12-Jan-2017	AA-	A1+	Stable	Maintain	-
12-Jan-2016	AA-	A1+	Stable	Upgrade	-

Rating Rationale and Key Rating Drivers

The ratings signify Dawood Hercules Corporation Limited's (DH Corp) strong risk profile as an InvestCo. DH Corp is currently transforming its investment portfolio and has taken an exit from the energy sector (Hub Power Company Limited), which has materialized into healthy gains. The proceeds from the divestment of HUBCO investment have been placed in money market instruments. DH Corp is no longer pursuing the transaction to acquire 45% equity stake in Edotco Pakistan (Private) Limited. The Company is in the process of evaluating new investment opportunities including in the technology sector. Meanwhile, DH Corp is expected to have a steady, indeed increasing, dividend stream from Engro Corp. The business acumen of the sponsoring family and strong governance practices provide support to the ratings.

The ratings require upholding strong overall risk profile. The Company enjoys sizeable liquid funds from divestiture in HUBCO, giving it ample cushion for debt servicing. At the same time, the management's commitment to maintain existing debt levels and coverages would be critical.

Disclosure

Name of Rated Entity	Dawood Hercules Corporation 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),Methodology Holding Company (Jun-18)
Related Research	Sector Study Holding Company(Aug-18)
Rating Analysts	Adnan Dilawar adnan@pacra.com +92-42-35869504



Profile

Legal Structure Dawood Hercules Corporation Limited is a public limited company listed on the Pakistan Stock Exchange.

Background The Company was incorporated in Pakistan on April 17, 1968 under the Companies Act, 1913 (now Companies Act, 2017) as Dawood Hercules Chemicals Limited. As a result of restructuring in January 2011, Dawood Hercules Chemicals Limited demerged its fertilizer operations by establishing a wholly owned subsidiary – DH Fertilizers Limited. As a result Dawood Hercules Chemicals Limited was renamed to Dawood Hercules Corporation Limited.

Operations The principal activity of the Company is to manage investments in its subsidiary and associated companies. The registered office of the Company is in Karachi.

Ownership

Ownership Structure As at Dec' 17, Dawood Group (Dawood Family and associates) holds 34% stake in DH Corp through its' corporate entities (20%) and individuals (14%). Other related foreign companies hold 54% shareholding in DH Corp, 9% is held by corporate and financial institutions whereas around 3% is held general public.

Stability Ownership of the business is seen as stable as the major ownership vests with the sponsors i.e. Dawood Family.

Business Acumen DH Group is a conglomerate with over three generations of experience in commercial and social enterprises. Currently, the Group 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 to the success of the companies within the Group.

Financial Strength Dawood Group's main holding companies are DH Corp and Dawood Lawrencepur Limited. The Groups' main investments in Engro Corp are consolidated in DH Corp while investments in energy sector are consolidated in Dawood Lawrencepur Limited. In addition, the Group's businesses include Cyan Limited (a listed entity, engaged in making equity investments in companies with high growth potential). DH Corp has a strong consolidated asset base of ~ PKR402bln supported by an equity base of ~ PKR 198bln as at Sept-18. Consolidated Revenue stood at ~ PKR 115bln for 9MCY18.

Governance

Board Structure The Board Structure remains same (10 directors out of which 2 are independent)

Members' Profile The Board is chaired by Mr Hussain Dawood, the patriarch of Dawood Family. He is a Pakistani businessman and ardent philanthropist and chairs an array of profit and not-for-profit ventures. The Company's board collectively has a diversified skill set ranging from financial sector to manufacturing energy including technology sectors.

Board Effectiveness Board has three committees to assist the Board in governing the affairs of the Company. These comprise: a) Board Compensation Committee, b) Board Audit Committee, and c) Board Investment Committee. The Board dissolved Special Transaction Committee and constituted Board Investment Committee during the current year. The Board met six times during CY17 which had an average of 70% attendance. The Audit committee met as per its regulatory requirements, 4 times during the year. The Compensation Committee and Special Transaction Committee met once and five times during the same period, respectively.

Financial Transparency DH Corp's External Auditors are A.F. Ferguson & Co who have issued an unqualified auditor's report on CY17 financial statements. The firm has been the Company's auditors since 2012.

Management

Organizational Structure The Company operates through seven departments namely: a) Investment, b) Finance, c) Corporate affairs, d) Human Resource, e) Protocol and Services, f) Information Technology and g) Internal Audit. All department heads report directly to the CEO. The head of internal audit department reports administratively to the CEO and functionally to Board Audit Committee.

Management Team Mr. Inam-Ur-Rehman, is serving as CEO since Dec '16. Before joining DH Corp he held the position of CEO at Dawood Lawrencepur Limited, Reon Limited and Tenaga Generasi Limited. During the year Mr. Muhammad Shamoony Chaudry joined as CFO in place of Mr. Shafiq Ahmed. He has a Masters in Finance from London Business School and a MBA from Lahore University of Management Sciences (LUMS). He has more than 23 years of progressive and varied experience in the financial sector.

Effectiveness The members of DH Corp's Board are also present on the Board of their investee companies that helps exercise greater oversight and control.

MIS DH Corp generates a standardized quarterly MIS for its board 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 DH Corp previously had outsourced its internal audit function to Ernst & Young Ford Rhodes Chartered Accountants. The Company now has an in-house internal audit department headed by Certified Internal Control Auditor (CAA).

Business Risk

Industry Dynamics Holding companies are an emerging phenomena in Pakistan. Some operating companies that held strategic investments, for the purpose of diversification and growth, eventually de-merged from their operations and structured itself so that holding companies could concentrate their investments for the purpose of business growth and diversification.

Relative Position DH Corp enjoys a sizable position in the universe of Holding Companies. The Company's only subsidiary, Engro Corp is engaged in various sectors of the economy. Its fertilizer business is ranked among top fifty fertilizer manufacturers in the world. The dairy business is the market leader in Pakistan's UHT market and number 2 dairy dessert brand serving over 12 million consumers. In chemical storage and handling business, the Company has set up Pakistan's first LNG receiving terminal, and a integrated bulk liquid chemical & LPG terminal. The energy side of the Company is operating Pakistan's first 217MW power plant on permeate gas. The mining business in a JV with the Government of Sindh and CMEC, is developing Pakistan's first open-pit coal mine.

Revenues DH Corps' topline comprises of dividend income from its investee company i.e Engro Corp. On a standalone basis, the topline for 9MCY18 stood at PKR 2,988mln reflecting a decline of 19.75% as against PKR 3,723mln for the same period last year. This decline is due to the lower dividends from Engro Corp and divestment of HUBCO.

Margins Finance cost increased by 91% amounting to PKR 685mln (PKR 358mln same period last year) owing to increase in borrowings and interest rates. Other income supported the bottom line by PKR 4,494mln which includes profit from short term fixed income investments (PKR 951mln) and gain on disposal of HUBCO investment (PKR 3,542mln). During the year the Company booked at capital gain of PKR 3,542mln (owing to divestment of HUBCO shares). Bottom line increased to PKR 5,450mln as compared to PKR 2,311mln in 9MCY17. Excluding the capital gain, the bottom line decreased by 17% closing in at PKR 1,908mln.

Sustainability Going forward, the Company plans to explore further investment avenues for diversification and growth.

Financial Risk

Working Capital The Company holds sizeable liquid investment (~PKR 23bln) in the form of T-bills and there are no short term borrowings as at Sept-18

Coverages In line with the increase in leveraging, reduction in dividend streams and divestment of HUBCO investment, the Company's interest coverage deteriorated from 9.3x in CY17 to 1.2x in 9MCY18. The Company holds sizeable liquid funds (~PKR 23bln) in the form of T-bills to service its debt obligations.

Capitalization DH Corp has two sukuks of PKR 5.2bln and PKR 6bln for a period of five years, bringing its total debt to ~ PKR 11bln at end of Sept-18. These sukuks bear a 3MK+1% profit rate and will mature in Nov '22 and Feb '23, respectively. The Company has witnessed an increasing debt:capital ratio since CY15. With the new sukuks, the ratio clocked in at 24% at end Sept-18 from 16% in Dec '17. The Company maintains a moderate level of leveraging.



Dawood Hercules Corporation Limited (DH Corp)

BALANCE SHEET	30-Sep-18	31-Dec-17	30-Dec-16	30-Dec-15
	9M	Annual	Annual	Annual
Non-Current Assets	134	157	126	133
Investments (Incl. associates)	45,945	39,147	37,478	37,574
Equity	23,309	37,478	37,478	37,574
Others	22,636	1,669	-	-
Advance against Investment	-	-	-	-
Current Assets	3,204	297	347	1,164
Inventory	-	-	-	-
Trade Receivables	-	-	-	-
Others	3,204	297	347	1,164
Total Assets	49,283	39,601	37,950	38,871
Debt	11,178	6,381	6,758	4,424
Short-term	-	1,242	2,869	432
Long-term (Incl. Current Maturity of long-term debt)	11,178	5,140	3,889	3,993
Other short-term liabilities	2,294	450	351	651
Other Long-term Liabilities	1	4	2	-
Shareholder's Equity	35,810	32,766	30,839	33,795
Total Liabilities & Equity	49,283	39,601	37,950	38,871

INCOME STATEMENT

Turnover	2,988	5,779	7,422	21,932
Gross Profit	2,441	5,287	6,675	20,642
Other Income	4,494	2	12	284
Financial Charges	(685)	(493)	(393)	(219)
Net Income	5,450	3,852	5,470	20,194

Cashflow Statement

Free Cashflow from Operations (FCFO)	770	4,589	5,873	20,264
Net Cash changes in Working Capital	(1,627)	(111)	(152)	84
Net Cash from Operating Activities	(1,429)	3,980	5,328	20,194
Net Cash from Investing Activities	19,784	(1,729)	(9)	(16,797)
Net Cash from Financing Activities	4,978	(681)	(6,041)	(2,138)

Ratio Analysis

Performance				
Turnover Growth	-19.7%	-22.1%	45.9%	71.6%
Gross Margin	81.7%	91.5%	89.9%	94.1%
Net Margin	182.4%	66.7%	73.7%	92.1%
ROE	20.6%	11.6%	17.3%	58.8%
Capital Structure (Total Debt/Total Debt+Equity)	23.8%	16.3%	18.0%	11.6%

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+ 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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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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(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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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.
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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)
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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)
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- (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)

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- (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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