



The Pakistan Credit Rating Agency Limited

Rating Report

Dawood Hercules Corporation Limited | Sukuk

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
28-Jun-2019	AA	-	Stable	Maintain	-
28-Dec-2018	AA	-	Stable	Maintain	-
28-Jun-2018	AA	-	Stable	Initial	-
19-Oct-2017	AA	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The ratings reflect Dawood Hercules Corporation Limited's (DH Corp) strong profile as an InvestCo holding significant investments through its subsidiary Engro Corp. Divestment in Hub Power Company Limited at healthy gains has led to accumulation of sizeable liquid funds. The Company continues to hold these funds in money market instruments and has recently started investing in blue chip market securities indicating very strong liquidity. DH Corp is exploring new investments avenues to add to its portfolio including those in the technology sector. Meanwhile, DH Corp is expected to have a steady and increasing dividend stream from its subsidiary, Engro Corp, which has announced a new investment of up to PKR 7.5bln in the telecom sector in April'19 through Enfrashare, a wholly owned subsidiary of Engro Infiniti. Further, Engro Energy Limited have also announced significant investments in the energy sector. The business acumen of the sponsoring family and strong governance practices provide support to the ratings.

The ratings require upholding strong overall risk profile and prudent investment policy by the Company. DH Corp enjoys sizeable liquid funds from divestment in HUBCO, giving it ample liquidity and 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 Sukuk
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Sukuk(Jun-18),Methodology Debt Instrument(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Holding Company (Jun-18)
Related Research	Sector Study Holding Company(Aug-18)
Rating Analysts	Silwat Malik silwat.malik@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 including in its subsidiary and associated companies. The group's business portfolio spans across various sectors including chemical fertilizers, PVC, food, power generation, coal mining and LNG storage. The registered office of the Company is in Karachi.

Ownership

Ownership Structure As at Apr'19, 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 3% is held by 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 ~ PKR435bln supported by an equity base of ~ PKR 208bln as at Mar'19. Consolidated Revenue stood at ~ PKR 171bln for CY18 (~PKR 40bln: 3M CY19).

Governance

Board Structure BoD has ten members. All except the CEO are non- executive. It has four members from the Dawood family and two independent directors.

Members' Profile The Board is chaired by Mr Hussain Dawood, the patriarch of Dawood Family. He is a Pakistani businessman and philanthropist and chairs an array of profit and not-for- profit ventures. All members are seasoned professionals with experiences in energy, chemical, technology and financial sectors, bringing a diverse range of requisite skills to the BoD.

Board Effectiveness Board has three committees to assist the Board in governing the affairs of the Company. These comprise: a) Human Resource & Remuneration Committee, b) Board Audit Committee, and c) Board Investment Committee. The Board met eight times during CY18 with an average attendance of ~80%. The audit committee met four times during the year, while the Human Resource and Remuneration Committee met five times during the year, respectively.

Financial Transparency DH Corp's External Auditors are A.F. Ferguson & Co who have issued an unqualified auditor's report on CY18 financial statements.

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. Mr. Muhammad Shamooun Chaudry joined as CFO in place of Mr. Shafiq Ahmed during CY18. He has a Masters in Finance from London Business School and a MBA from Lahore University of Management Sciences (LUMS). He has more than 25 years of progressive and varied experience in the financial sector.

Effectiveness Key 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 inhouse internal audit department headed by Certified Internal Control Auditor (CIA).

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 owing to it's subsidiary, Engro Corp. The subsidiary is engaged in various sectors of the economy. The fertilizer business is the second largest producer in it's sector in Pakistan. The PVC business is the sole producer of PVC in Pakistan, with 66% market share of domestic PVC demand. The dairy business is the market leader in Pakistan's UHT market and number 2 dairy dessert brand serving over 12 million consumers. Company operates 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 CY18 stood at PKR 4,353mln reflecting a decline of ~25% as against PKR 5,778mln for the same period last year. The trend continued during 3M CY19 to ~PKR 584mln compared to similar period last year (3M CY18:PKR 748mln). This decline is due to the lower dividends from Engro Corp and discontinuation of dividend stream from HUBCO post divestment in CY18.

Margins Finance cost increased by ~80% amounting to PKR 883mln in CY18 (PKR 493mln: CY17) owing to increase in borrowings and interest rates. Other income supported the bottom line by PKR 5,020mln which includes profit from short term fixed income investments (PKR 1,477mln) and gain on disposal of HUBCO investment (PKR 3,542mln). Bottom line increased to ~PKR 6,053mln as at CY18 compared to PKR 3,852mln in CY17. Excluding the one time capital gain (net of tax), the profit was PKR 2,490mln. Bottom-line during 3M CY19 was lower at ~PKR 109mln (~PKR 3,848mln: 3M CY18) due to last year's one-off capital gains, higher finance costs and lower dividend income.

Sustainability Going forward, the Company plans to explore further investment avenues for diversification and growth. It's subsidiary, Engro Corp has announced a new investment of up to PKR 7.5bln in the telecom sector in April'19 through Enfrashare, a wholly owned subsidiary of Engro Infiniti. Further, Engro Energy Limited has announced investment in four solar power plants of 50MW each in Balochistan for \$144mln. These plants are expected to achieve commercial operation date by June 2020.

Financial Risk

Working Capital The Company being a holding company has limited/ no working capital needs in line with it's operations. The Company holds sizeable liquid investment (~PKR 23bln) in the form of T-bills with no short term borrowings as at Mar'19.

Coverages In line with the increase in leveraging, reduction in dividend streams, the Company's interest coverage deteriorated from 9.3x in CY17 to 0.1x in 3M CY19. The Company holds sizeable liquid funds (~PKR 23bln) in the form of T-bills to service its debt obligations.

Capitalization DH Corp has two sukuk of PKR 5.2bln and PKR 6bln for a period of five years, bringing its total debt to ~ PKR 11bln at end of Mar'19. These sukuk bear a 3Mk+1% profit rate and will mature in Nov '22 and Feb '23, respectively. DH Corp | Sukuk II is exercisable via a Call option while Call option on DH Corp | Sukuk will trigger post Nov'19. The Company has witnessed an increasing leveraging since CY15. With the new sukuk, the ratio clocked in at 24% at end of Mar'19 up from 16% in Dec '17. The Company maintains a moderate level of leveraging.



Dawood Hercules Corporation Limited (DH Corp)

BALANCE SHEET

	31-Mar-19 3M Un-Audited Accounts	31-Dec-18 Annual Audited Accounts	31-Dec-17 Annual Audited Accounts	31-Dec-16 Annual Audited Accounts
Non-Current Assets	130	137	157	126
Investments (Incl. associates)	46,652	45,051	39,147	37,478
Equity	23,753	23,516	37,478	37,478
Others	22,899	21,535	1,669	-
Advance against Investment	-	-	-	-
Current Assets	556	2,146	297	347
Inventory	-	-	-	-
Trade Receivables	-	-	-	-
Others	556	2,146	297	347
Total Assets	47,337	47,334	39,601	37,950
Debt	11,106	11,227	6,381	6,758
Short-term	-	121	1,242	2,869
Long-term (Incl. Current Maturity of long-term debt)	11,106	11,106	5,140	3,889
Other short-term liabilities	1,152	1,137	450	351
Other Long-term Liabilities	6	6	4	2
Shareholder's Equity	35,073	34,964	32,766	30,839
Total Liabilities & Equity	47,337	47,334	39,601	37,950

INCOME STATEMENT

Turnover	603	4,353	5,779	7,422
Gross Profit	448	3,343	5,287	6,675
Other Income	3	5,020	2	12
Financial Charges	(304)	(883)	(493)	(393)
Net Income	109	6,054	3,852	5,470

Cashflow Statement

Free Cashflow from Operations (FCFO)	(245)	(2,354)	4,589	5,873
Net Cash changes in Working Capital	1,596	222	(111)	(152)
Net Cash from Operating Activities	1,057	(2,955)	3,980	5,328
Net Cash from Investing Activities	341	23,596	(1,729)	(9)
Net Cash from Financing Activities	(1)	2,104	(681)	(6,041)

Ratio Analysis

Performance

Turnover Growth	-7.1%	-24.7%	-22.1%	-66.2%
Gross Margin	74.4%	76.8%	91.5%	89.9%
Net Margin	18.1%	139.1%	66.7%	73.7%
ROE	1.2%	17.0%	11.6%	17.3%

Capital Structure (Total Debt/Total Debt+Equity)	24.0%	24.3%	16.3%	18.0%
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DEBT INSTRUMENT RATING SCALE & DEFINITIONS

The instrument rating reflects forward-looking opinion on credit worthiness of underlying debt 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.			
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+:	The highest 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.	A1:	A strong capacity for timely repayment.	
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.	A2:	A satisfactory capacity for timely repayment. This may be 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.	A3:	An adequate capacity for timely repayment. Such capacity is 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.	B:	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.	
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.	C:	An inadequate capacity to ensure timely repayment.	
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) 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

Disclaimer: PACRA's ratings are an assessment of the credit standing of an entity/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.

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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(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)

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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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Regulatory and Supplementary Disclosure

Name of Issuer Dawood Hercules Corporation Limited
Name of Issue Dawood Hercules Corporation Limited | Sukuk 1
Sector Holding Company
Type of Relationship Solicited
Purpose of the Rating Independent Risk Assessment

Nature of Instrument Sukuk	
Name of Issuer	Dawood Hercules Corporation Limited
Placement	Over the counter listed securities, issued to qualified institutional buyers through private placements
Issue size	PKR 5.2bln
Issue Date	16-Nov-17
Tenor	5 yrs including a 15 month grace period
Maturity	15-Nov-22
Profit Rate	3MK + 1% (Quarterly in Arrears)
Principal Repayment	8 step-up semi-annual payments in arrears
Call Option	Exercisable in full at any time after two (2) years of the Issue Date on a profit payment date, subject to a 30 days' notice;
Security	<ul style="list-style-type: none"> • Pledge of shares of Engro Corporation Limited, inclusive of 50% margin, in a designated CDC account. In the event of any sale and repurchase of security. • Floating or Hypothecation charge on all present and future assets of the Company inclusive of a 25% margin.
Market Value	PKR 10,931,555,692/- (As at 31-May-2019)
Trustee	JS Bank Limited

Dawood Hercules Corporation Limited Sukuk Redemption Schedule						
Opening Principal	Principal Repayment	Markup		Markup Payment	Installment Payable	Principal Outstanding
		PKR in mln	Due Date			
						5,200
5,200	-		15-Feb-19	11.5%	150	5,200
5,200	520		17-May-19	11.5%	150	4,680
4,680			16-Aug-19	14.0%	163	4,680
4,680	520		16-Nov-19	14.0%	163	4,160
4,160			15-Feb-20	14.0%	145	4,160
4,160	520		16-May-20	14.0%	145	3,640
3,640			15-Aug-20	14.0%	127	3,640
3,640	520		15-Nov-20	14.0%	127	3,120
3,120			14-Feb-21	14.0%	109	3,120
3,120	520		16-May-21	14.0%	109	2,600
2,600			15-Aug-21	14.0%	91	2,600
2,600	520		15-Nov-21	14.0%	91	2,080
2,080			14-Feb-22	14.0%	73	2,080
2,080	1,040		16-May-22	14.0%	73	1,040
1,040			15-Aug-22	14.0%	36	1,040
1,040	1,040		15-Nov-22	14.0%	36	-