



The Pakistan Credit Rating Agency Limited

## Rating Report

### Descon Oxychem 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
01-Jul-2021	A	A1	Positive	Maintain	-
01-Jul-2020	A	A1	Positive	Maintain	-
02-Jul-2019	A	A1	Positive	Maintain	-
31-Dec-2018	A	A1	Positive	Maintain	-
30-Jun-2018	A	A1	Stable	Maintain	-
30-Jun-2017	A	A1	Stable	Maintain	-
22-Sep-2016	A	A1	Stable	Maintain	-
11-Dec-2015	A	A1	Stable	Maintain	-

#### Rating Rationale and Key Rating Drivers

The ratings recognize Descon Oxychem’s leading position in the local Hydrogen Peroxide (HPO) market, supplemented by efficient production processes, sound technological infrastructure and effective control environment. One of the only two manufacturers in Pakistan’s market, Descon Oxychem has gradually strengthened its footprint; particularly in the North region. After COVID-19 outbreak and subsequent lockdown, HPO prices have gone down due to lower demand, especially from the textile sector. Demand from textile has then revived on account of eventual easing of lockdown and resumption of operations. The Company managed to sustain its revenue during these challenging times through product diversification. The Company has introduced multipurpose disinfectant / sanitizer products to support its business profile. The Company has successfully completed its expansion project with increase of 25% capacity and plant has achieved new designed capacity in Feb21. Meanwhile, the financial risk profile remains strong characterized by efficient working capital management and strong coverages. The Company has obtained long term loan for expansion project and leveraging has gone up but yet manageable. Ratings further draw comfort from Descon Oxychem’s association with a financially sound and experienced business group - DESCON - which has continuously demonstrated support.

The ratings are dependent on improved competitiveness of the Company through product diversification to mitigate slowdown in demand. Timely translation of the expansion plan into better profitability would positively impact the ratings. Meanwhile, smooth operations from the current plant would remain important. Maintaining strong coverages and sustainable leveraging will remain critical.

#### Disclosure

<b>Name of Rated Entity</b>	Descon Oxychem Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-20),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria   Rating Modifier(Jun-20)
<b>Related Research</b>	Sector Study   Chemical(Jul-20)
<b>Rating Analysts</b>	Sohail Ahmed Qureshi   sohail.ahmed@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Descon Oxychem Limited (Descon Oxychem) is a public listed company incorporated under the Companies Ordinance, 1984 (now "Companies Act, 2017").

**Background** Descon Oxychem was incorporated as a private limited company in 2004 and was listed in September, 2008. It is a project of the Descon Group. Following commissioning in October 2008, the Company's plant started commercial production in March 2009.

**Operations** The main business of Descon Oxychem is the manufacture and distribution of Hydrogen Peroxide (HPO) up to 60% concentration. Its production facility is located at 18 KM Lahore Shekhupura Road consisting of an HPO plant with a capacity of 28,000 MT per annum and a Hydrogen plant. Capacity of the plant has been increased by 25% with effect from Feb-21.

## Ownership

**Ownership Structure** The principal sponsor of Descon Oxychem holds majority shareholding ~73.56% through associated companies while 26.44% stake rests with the general public and financial institutions.

**Stability** The transfer of the Company's ownership to a holding company provides clarity to Descon Oxychem's ownership structure, boding well for its stability.

**Business Acumen** Descon Oxychem has been operating in engineering, chemicals and power as its core businesses since 1977. Mr. Abdul Razak Dawood, current Advisor to the Prime Minister for Commerce, Textile, Industry and Production, is founder and former Chairman of the Descon Group. The Razak Dawood Family is one of the well-known business families of the Country.

**Financial Strength** The Descon Group has expanded its footing in diversified business avenues with a sizable portfolio of strategic investments, enhancing the Group's financial strength. The Group has shown willingness and ability to support the Group companies in times of need.

## Governance

**Board Structure** Descon Oxychem's Board comprises eight-members comprising one executive director, four non-executive, and three independent members. The Board structure is considered strong.

**Members' Profile** Descon Oxychem's Board comprises highly qualified members and has a blend of business studies, engineering and finance professionals. Mr. Taimur Dawood, Chairman, leads the Board with over 16 years of work experience in diversified sectors.

**Board Effectiveness** Strong attendance of Board members in Board meetings and proper documentation of minutes bodes well for the Board's effectiveness. Further, four Board committees have been formed to assist the Board.

**Financial Transparency** A.F. Ferguson & Co., listed in Category "A" of the State Bank's panel of auditors, is the external auditor of the Company. They expressed an unqualified opinion on the Company's financial statements for FY20 and half yearly financial statements for 1HFY21. Meanwhile, the Company has outsourced its internal audit function to KPMG Taseer Hadi & Co.

## Management

**Organizational Structure** The Company operates through seven functional departments, each headed by an experienced manager. Some business functions including IT, Human Resources and Accounting & Finance are shared at Group level.

**Management Team** Mr. Muhammad Mohsin Zia has replaced Mr. Imran Qureshi as CEO of Descon Oxychem, with effect from April 21, 2021. Mr. Mohsin Zia holds MBA from Institute of Business Administration, Karachi and has 27 years of diverse experience in Marketing Services, Business Development, Sales Management, Supply Chain Management and Strategy, development. He is assisted by an experienced and professional management team.

**Effectiveness** Descon Oxychem's senior management receives daily performance reports of the plant's operations which results in optimal monitoring. Key management personnel meet on a daily and weekly basis to discuss key issues, reflecting well on the management's effectiveness.

**MIS** The Company has implemented the R12 version of the Oracle E-business suite application, which is also used at other associated companies of Descon. The ERP solution generates various MIS reports related to production, inventory management, sales and trade receivables/payables, resulting in increased efficiency.

**Control Environment** The Company's HPO plant was supplied by Chematur Engineering, Sweden; regular visits by Chematur's staff also ensure efficient operations and high quality of the final product. Descon Oxychem has been given the license to be the sole operator of Chematur technology in Pakistan. Descon Oxychem has implemented Quality hygiene Safety Model and Reliability Centre Management which helps in improving plant reliability.

## Business Risk

**Industry Dynamics** Pakistan's HPO industry presently comprises two players: Descon Oxychem and Sitara Peroxide with an installed capacity of 35,000 MT and 30,000 MT respectively. Currently, the domestic demand outstrips the supply and is estimated at ~69,500 MT. Hence, ~10-15% of demand is met through imports. Going forward, Engro Polymer and Chemicals is entering the HPO industry with 20,000 MT capacity. Anti-dumping duties have been imposed on multiple international players.

**Relative Position** Presently, Descon Oxychem remains the HPO market leader with a market share of more than 50%. With Engro Polymer and Chemicals' new plant, the Company's market share may diminish, going forward. However, with continually rising local demand and enhanced capacity expansion, Descon Oxychem is expected to remain the leading player.

**Revenues** Descon Oxychem derives its revenues predominantly from local sales (~99%) which is totally predominant to the textile sector for bleaching and dyeing purposes while the remaining minor portion of sales is made to food sector consumers. During 9MFY21, the top-line of the Company has shown slight growth of ~1.5% YoY and clocked in at ~PKR 2,119mln during 9MFY21 (9MFY20: ~PKR 2,087mln). Growth in revenue was hampered on account of outbreak of COVID-19 leading to lower demand.

**Margins** Descon Oxychem's gross margin showed YoY decline in 9MFY21 and was reported at ~23.8% (9MFY20: ~28.7%) on account of cost of planned annual turnaround, additional impact of depreciation due to expansion, higher prices of packing material and impact of one off high utilities factors owing to shut down. The same translated into the decreased operating profit margin (9MFY21: ~18.7%, 9MFY20: ~23.2%). Finance cost decreased by 47.6% YoY, however, this could not help the net margins to improve and net margins stood at 11% during 9MFY21 (9MFY20: 13%).

**Sustainability** Descon Oxychem regularly invests in BMR. Optimal capacity utilization is of utmost importance to enable the Company to manage its costs and sustain high margins. Efforts to penetrate new segments and markets have been successfully implemented alongside organic growth in Textile and Mining sectors. Company is also exploring options to diversify into downstream products which will further strengthen the usage of hydrogen peroxide in local market. The business continues to invest in areas which reinforce its advantageous position in safety, manufacturing efficiency and building market leadership in key geographies.

## Financial Risk

**Working Capital** Descon Oxychem's cash cycle remains robust as nearly all sales are on a cash basis while the Company is offered a credit period of 90 days by its sourcing partners. Over the years, working capital management has improved which is evident from the continuous reduction in the net cash cycle. Most of the Company's sales are cash-based, resulting in a very short net cash cycle which has improved over the years (9MFY21: 0 days, FY20: 1 day, FY19: -3 days).

**Coverages** Descon Oxychem witnessed a slight YoY increase of ~6% in its FCFO (free cash flow from operations) during 9MFY21, despite the lower profitability. In coverages, interest coverage improved YoY owing to lower finance cost (9MFY21: 10.8x, 9MFY20: 6.8x). The Company's debt coverage ratio deteriorated on account of current maturity of long term loan in 9MFY21 and clocked in at 3.6x in 9MFY21 (9MFY20: 6.8x).

**Capitalization** Descon Oxychem's leveraging has decreased significantly over the past few years. During 9MFY21 Company has obtained long term loan for the expansion project. PKR 895mln of this project cost has been financed through the Long term debt. Accordingly, leveraging increased to ~36.6% in 9MFY21 (FY20: ~13.2%). Short-term borrowings makes ~0.9% of the total borrowings of the Company.



Descon Oxychem Limited Chemicals	Mar-21 9M	Jun-20 12M	Jun-19 12M	Jun-18 12M
-------------------------------------	--------------	---------------	---------------	---------------

**A BALANCE SHEET**

1 Non-Current Assets	2,551	2,076	1,531	1,455
2 Investments	552	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	890	761	717	585
a Inventories	118	183	72	26
b Trade Receivables	104	55	81	39
5 Total Assets	3,993	2,837	2,248	2,039
6 Current Liabilities	560	417	327	263
a Trade Payables	265	200	175	90
7 Borrowings	1,166	295	269	1,100
8 Related Party Exposure	1	0	736	0
9 Non-Current Liabilities	247	189	133	-
10 Net Assets	2,020	1,935	784	676
11 Shareholders' Equity	2,020	1,935	784	676

**B INCOME STATEMENT**

1 Sales	2,119	2,642	2,705	2,088
a Cost of Good Sold	(1,615)	(1,780)	(1,874)	(1,472)
2 Gross Profit	504	861	831	616
a Operating Expenses	(107)	(154)	(127)	(152)
3 Operating Profit	397	708	703	465
a Non Operating Income or (Expense)	(21)	(37)	(43)	(6)
4 Profit or (Loss) before Interest and Tax	376	670	661	459
a Total Finance Cost	(40)	(81)	(267)	(269)
b Taxation	(100)	(170)	(184)	(132)
6 Net Income Or (Loss)	236	418	210	58

**C CASH FLOW STATEMENT**

a Free Cash Flows from Operations (FCFO)	548	772	711	591
b Net Cash from Operating Activities before Working Capital Changes	530	684	646	394
c Changes in Working Capital	97	10	(34)	54
1 Net Cash provided by Operating Activities	627	694	612	449
2 Net Cash (Used in) or Available From Investing Activities	(718)	(697)	(312)	(51)
3 Net Cash (Used in) or Available From Financing Activities	190	(21)	(382)	(306)
4 Net Cash generated or (Used) during the period	99	(24)	(83)	91

**D RATIO ANALYSIS**

1 Performance				
a Sales Growth (for the period)	6.9%	-2.3%	29.5%	6.5%
b Gross Profit Margin	23.8%	32.6%	30.7%	29.5%
c Net Profit Margin	11.1%	15.8%	7.8%	2.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	30.4%	29.6%	25.0%	30.9%
e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sh	18.2%	24.1%	28.1%	8.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	30	27	15	16
b Net Working Capital (Average Days)	0	1	-3	0
c Current Ratio (Current Assets / Current Liabilities)	1.6	1.8	2.2	2.2
3 Coverages				
a EBITDA / Finance Cost	11.9	8.4	3.2	2.3
b FCFO / Finance Cost+CMLTB+Excess STB	3.6	6.2	2.7	2.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.7	0.4	2.0	3.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	36.6%	13.2%	56.2%	62.0%
b Interest or Markup Payable (Days)	89.2	24.1	20.9	0.5
c Entity Average Borrowing Rate	11.1%	14.8%	23.5%	23.2%

**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
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
<b>AA+</b>	
<b>AA</b>	<b>Very high credit quality.</b> 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.
<b>AA-</b>	
<b>A+</b>	
<b>A</b>	<b>High credit quality.</b> 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.
<b>A-</b>	
<b>BBB+</b>	
<b>BBB</b>	<b>Good credit quality.</b> 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.
<b>BBB-</b>	
<b>BB+</b>	<b>Moderate risk.</b> 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>BB</b>	
<b>BB-</b>	
<b>B+</b>	
<b>B</b>	<b>High credit risk.</b> 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>B-</b>	
<b>CCC</b>	<b>Very high credit risk.</b> 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.
<b>CC</b>	
<b>C</b>	
<b>D</b>	Obligations are currently in default.

Scale	Short-term Rating Definition
<b>A1+</b>	The highest capacity for timely repayment.
<b>A1</b>	A strong capacity for timely repayment.
<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>A4</b>	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):

<p><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul>	<p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul>
--	---

**Disclaimer:** PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. Contents of PACRA documents may be used, with due care and in the right context, with credit to PACRA. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

### **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**

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent