



The Pakistan Credit Rating Agency Limited

# DAWOOD HERCULES CORPORATION LIMITED

|            | <b>NEW<br/>[JAN-17]</b> | <b>PREVIOUS<br/>[JAN-16]</b> |
|------------|-------------------------|------------------------------|
| Long-Term  | AA-                     | AA-                          |
| Short-Term | A1+                     | A1+                          |
| Outlook    | Stable                  | Stable                       |

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JANUARY 2017

## Profile

- The Dawood Hercules Group (DHG) comprises Dawood Hercules Corporation Limited, its associate concerns i.e. Engro Corporation Limited and Hub Power Company Limited. DHG's consolidated investment book was worth PKR 37.4bln at end-Dec16 (Dec-15: PKR 37.6bln). However the market value of its consolidated investments was at PKR. 84.7bln as at end-Dec16.

## Governance & Management

- The company's ten member Board of Directors and one deemed director. The board comprises of four representatives of the DG and the remaining six members are independent directors. Mr. Hussain Dawood, the patriarch of Dawood family, serves as the chairman of the board. DH Corp, with the help of McKinsey & Co, devised organizational structure with respect to three key areas including i) Organizational Development, ii) Strategy & iii) Corporate Governance.
- Mr. Samad Dawood, CEO of DH Corp. resigned from his office effective from 30<sup>th</sup> November 2016. Mr Inam succeeded him as a CEO effective from 1<sup>st</sup> December 2016. Mr. Inam, before joining held the position of CEO at Dawood Lawrencepur Limited, Reon Limited and Tenaga Generasi Limited.

## Performance

| Investments       | Revenue        |                |                | PAT           |               |               | Dividend Payout |               |              |
|-------------------|----------------|----------------|----------------|---------------|---------------|---------------|-----------------|---------------|--------------|
|                   | 9MCY16         | 2015           | 2014           | 9MCY16        | 2015          | 2014          | 9MCY16          | 2015          | 2014         |
|                   | 3MFY17         | 2015           | 2014           | 3MFY17        | 2015          | 2014          | 3MFY17          | 2015          | 2014         |
| Engro Corporation | 107,834        | 184,264        | 175,958        | 11,322        | 17,268        | 7,801         | 6,285           | 7,856         | 1,218        |
| HUBCO             | 22,442         | 86,415         | 131,484        | 1,903         | 11,575        | 9,853         | 2,095           | 9,257         | 8,080        |
| <b>Total</b>      | <b>130,276</b> | <b>270,679</b> | <b>307,442</b> | <b>13,225</b> | <b>28,843</b> | <b>17,654</b> | <b>8,380</b>    | <b>17,113</b> | <b>9,298</b> |

- DH Corp's standalone income comprises dividend income received from its subsidiary and associates. At end-Sep16, the dividend income clocked in at PKR 5,085mln compared to PKR 20,007mln same period last year registering 77% decline in revenue trend. This decline is on the back of one-time dividend declared by an ex-subsidiary. The overall revenue stream observed a slight increase. This is due to dividend inflow from Engro Corp of PKR 3.7bln at end Sep-16 (Dec15: PKR2.8bln; Sept-15: PKR 4.2bln).
- The company's administrative expenses also posted a decline of ~53% (Sep-16: PKR 544mln, Dec-15: PKR 1,290mln, Sep-15: PKR 1,207mln). The major dip is due to incurring of a one-time cost of PKR 443mln on account of consultation fee charged by Mckinsey & Co. DH Corp's finance costs experience increase marginally clocking in PKR 254mln as at Sep-16 (Dec-15: PKR 219mln, Sept-15: PKR 92mln).
- Engro's consolidated top line posted a decline of ~13.6% on YoY basis and stood at PKR 107.8bln as end-Sep16 (end Sep15: PKR 125bln). The decline in the topline is an outcome of lower UREA offtake and dip in Efoods sales volume due to change in tax regime. The group's finance costs decreased significantly by ~ 31% on YoY basis and were at PKR 4.5bln at end-Sep16 (end-Sep15: PKR 6.4bln).
- During 1QFY17, Hubco's topline clocked at ~PKR 22bln (FY16: ~PKR 86bln). This is due to lower Net electrical output mainly Laraib plant. The company's bottom-line, however, improved on the back of cost efficiencies and reduction in finance.

## Financial Risk

- DH Corp, has a low leveraged capital structure. The company has availed long term finances worth PKR 3.7bln at Sep-16. The term of the loan is 5 years payable semi-annually at the rate of 6MKibor+200bps. The first installment is due on May 2018 and loan would be fully repaid by 2021. The loan is secured against HUBCO shares. With an equity base of PKR 29.9bln, the debt: equity clocked in at 14% (Dec-15: 11.6%) indicating an adequate leveraging of the company

## RATING RATIONALE

The ratings signify holding company stature of DH Corp. DH Corp's financial profile continues to benefit from the ensuing dividend stream, which is expected to increase with improving performance – core & strategic investments. The focus is towards identified sectors, especially energy, with clarity that DH Corp would expand through associates/partnerships primarily. The ratings reflect continuous augmenting of the monitoring mechanism thereby providing strategic guidance to the investee companies. The oversight of investments is done through a structured process, an important pillar of which is the analytical team in DH Corp with presence of nominee directors on the boards of investee companies. The business acumen of the sponsoring family and strong governance practices provide support to the ratings.

## KEY RATING DRIVERS

The ratings are dependent upon the group's overall risk profile. The targeted growth may not elicit rise in the risk exposure. At the same time, the group's financial metrics must remain strong.



**Dawood Hercules Corporation Limited (DHCL)**

| <b>BALANCE SHEET</b>                                 | <b>30-Sep-16</b> | <b>30-Dec-15</b> | <b>31-Dec-14</b> |
|--|------------------|------------------|------------------|
|  | <b>Annual</b>    | <b>Annual</b>    | <b>Annual</b>    |
| <b>Non-Current Assets</b>                            | <b>134</b>       | <b>133</b>       | <b>78</b>        |
| <b>Investments (Incl. associates)</b>                | <b>37,478</b>    | <b>37,574</b>    | <b>20,570</b>    |
| Equity   | 37,478           | 37,574           | 20,570           |
| Debt   | -                | -                | -                |
| <b>Current Assets</b>                                | <b>2,100</b>     | <b>1,164</b>     | <b>35</b>        |
| Inventory  | -                | -                | -                |
| Trade Receivables                                    | -                | -                | -                |
| Others   | 2,100            | 1,164            | 35               |
| <b>Total Assets</b>                                  | <b>39,712</b>    | <b>38,871</b>    | <b>20,858</b>    |
| <b>Debt</b>  | <b>4,966</b>     | <b>4,424</b>     | <b>766</b>       |
| Short-term   | 1,077            | 432              | 436              |
| Long-term (Incl. Current Maturity of long-term debt) | 3,889            | 3,993            | 330              |
| Other shortterm liabilities                          | 4,809            | 651              | 233              |
| Other Longterm Liabilities                           | 5                | -                | 0                |
| <b>Shareholder's Equity</b>                          | <b>29,931</b>    | <b>33,795</b>    | <b>19,858</b>    |
| <b>Total Liabilities &amp; Equity</b>                | <b>39,712</b>    | <b>38,871</b>    | <b>20,858</b>    |

**INCOME STATEMENT**

|                   |              |               |              |
|-------------------|--------------|---------------|--------------|
| <b>Turnover</b>   | <b>5,085</b> | <b>21,932</b> | <b>1,653</b> |
| Gross Profit      | 4,541        | 20,642        | 1,241        |
| Other Income      | 9            | 284           | (84)         |
| Financial Charges | (254)        | (219)         | (122)        |
| <b>Net Income</b> | <b>3,600</b> | <b>20,194</b> | <b>860</b>   |

**Cashflow Statement**

|                                      |         |          |       |
|--------------------------------------|---------|----------|-------|
| Free Cashflow from Operations (FCFO) | (836)   | (1,668)  | (572) |
| Net Cash changes in Working Capital  | (218)   | 84       | (40)  |
| Net Cash from Operating Activities   | 2,434   | 20,194   | (120) |
| Net Cash from Investing Activities   | (12)    | (16,797) | 686   |
| Net Cash from Financing Activities   | (2,579) | (2,138)  | (52)  |

**Ratio Analysis**

|  |        |       |       |
|--|--------|-------|-------|
| <b>Performance</b>   |        |       |       |
| Turnover Growth  | 36.7%  | 71.6% | 79.2% |
| Gross Margin   | 89.3%  | 94.1% | 75.1% |
| Net Margin   | 70.8%  | 92.1% | 52.0% |
| ROE  | 16.3%  | 58.8% | 1.5%  |
| <b>Coverages</b>   |        |       |       |
| Interest Coverage (FCFO/Gross Interest)  | -3.3   | -7.5  | -4.6  |
| Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)                                | -0.3   | -5.1  | -0.7  |
| Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)                            | 0.9    | 63.0  | 0.1   |
| Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest) | -5.3   | -2.1  | -1.4  |
| <b>Liquidity</b>   |        |       |       |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)                     | -110.3 | -86.9 | 57.5  |
| <b>Capital Structure</b> (Total Debt/Total Debt+Equity)                              | 14.2%  | 11.6% | 3.7%  |



## STANDARD 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  |
|---|--|---|
| <b>AAA</b><br><br><b>AA+</b><br><b>AA</b><br><b>AA-</b><br><br><b>A+</b><br><b>A</b><br><b>A-</b> | <p><b>Highest credit quality.</b> Lowest expectation of credit risk.<br/>Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.</p> <p><b>Very high credit quality.</b> Very low expectation of credit risk.<br/>Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.</p> <p><b>High credit quality.</b> Low expectation of credit risk.<br/>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.</p> | <p><b>A1+:</b> The highest capacity for timely repayment.</p> <p><b>A1:</b> A strong capacity for timely repayment.</p> <p><b>A2:</b> A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>A3:</b> An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>B:</b> The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>C:</b> An inadequate capacity to ensure timely repayment.</p> |
| <b>BBB+</b><br><b>BBB</b><br><b>BBB-</b>  | <p><b>Good credit quality.</b> Currently a low expectation of credit risk.<br/>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.</p>   |   |
| <b>BB+</b><br><b>BB</b><br><b>BB-</b>   | <p><b>Speculative.</b> Possibility of credit risk developing.<br/>There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.</p>  |   |
| <b>B+</b><br><b>B</b><br><b>B-</b>  | <p><b>Highly speculative.</b> Significant credit risk.<br/>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.</p>   |   |
| <b>CCC</b><br><b>CC</b><br><b>C</b>   | <p><b>High default risk.</b> Substantial credit risk<br/>“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.</p>   |   |
| <b>D</b>  | <p>Obligations are currently in default.</p>   |   |

|   |   |  |   |
|---|---|--|---|
| <p><b>Rating Watch</b><br/>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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.</p> | <p><b>Outlook (Stable, Positive, Negative, Developing)</b><br/>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’.</p> | <p><b>Suspension</b><br/>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.</p> | <p><b>Withdrawn</b><br/>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, or e) the entity/issuer defaults.</p> |
|---|---|--|---|

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**Name of Issuer**  
**Sector**  
**Type of Relationship**  
**Purpose of the Rating**

Dawood Hercules Corporation Limited  
 Holding Company  
 Solicited  
 Independent Risk Assessment

**Rating History**

| Dissemination Date | Long Term | Short Term | Outlook | Action   |
|--------------------|-----------|------------|---------|----------|
| 12-Jan-17          | AA-       | A1+        | Stable  | Maintain |
| 12-Jan-16          | AA-       | A1+        | Stable  | Upgrade  |
| 12-Jan-15          | A+        | A1         | Stable  | Initial  |

**Related Criteria and Research**

Rating Methodology

Corporate Rating Methodology

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[Rating Team Statement](#)

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[Probability of Default \(PD\)](#)

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