



The Pakistan Credit Rating Agency Limited

DESCON OXYCHEM LIMITED

	NEW [SEP-16]	PREVIOUS [DEC-15]
Long-Term	A	A
Short-Term	A1	A1
Outlook	Stable	Stable

REPORT CONTENTS
1. RATING ANALYSES
2. FINANCIAL INFORMATION
3. RATING SCALE
4. REGULATORY AND SUPPLEMENTARY DISCLOSURE

Profile & Ownership

- DOL, incorporated in 2004, is listed on Pakistan Stock Exchange and produces H2O2. The plant started commercial production in Mar09.
- DESCON, the principal sponsor of DOL, holds majority shareholding (61%) through associated companies (28%) and sponsoring family members (33%).
- DESCON has footholds in engineering business through its flagship company – Descon Engineering Limited. DESCON, over the years, has expanded its horizons beyond Pakistan, particularly the Middle East.

Governance

- Eight member board of directors including the CEO. Five members from the parent while two members are ID and one is NED.
- Mr. Razzak Dawood - founder and Head of DESCON - is the Chairman of the board.
- Four board committees in place; , (i) Enterprise Risk Management Committee, (ii) Audit Committee, (iii) Human Resource & Remuneration Committee and (iv) Compliance Committee

Management & Controls

- Mr. Aamir Niazi - CEO of the company holds experience of over thirty five years in the field of textile, chemicals and engineering.
- During the year, Mr. Yasir Siddiqui left his position as CFO DOL and joined Descon Engineering Limited and Mr. Saqib Abbas took the charge of CFO DOL.
- The company operates through seven departments, each headed by an experienced manager. In order to rationalize costs some business functions (IT, HR& Finance) are shared at group level.

Business Risk

- The major consumer of HPO in the domestic market is the Textile Industry; it represents more than three-fourth of the total domestic demand; this is followed by Paper & Board industry.
- During 9MFY16 the topline of company improved (9MFY16: PKR 1132mln; 9MFY15: PKR 1035mln) backed the increased selling price although volumes remained largely at the same level.
- The company’s planned turnaround cost during 3QFY16 was PKR ~22mln. Turnaround phase also reduced topline of DOL by PKR ~27mln.
- Gross profit of the company witnessed a massive improvement (9MFY16: PKR 212mln; 9MFY15: PKR 132mln) due a reduction in COGS. Energy cost constitute ~25% of total production cost, reduced to ~19% due to reduction in power cost both from the grid and company’s own generation.
- Improved topline, better performance management and lower finance cost elevated the net profit as the bottom-line of the company ended green (9MFY16: PKR 23mln; 9MFY15: PKR -128mln).
- Going forward, DOL is eyeing to setup a new plant in south to cater demand from central Asia while debottlenecking of existing Plant will increase the capacity of the company from 96 MT per day 103 MT per day.

Financial Risk

- DOL’s cash cycle remained robust as almost all sales are on cash basis while the company is offered a credit period of 180 days by its sourcing partners.
- The Company’s cash flows remain a function of its profitability. During 9MFY16, DOL’s Cash flows improved on account of superior profits.
- During FY16, DOL issued preference shares of PKR 1.1bln. The preference shares are convertible cumulative redeemable carrying entitlement to a fixed annual cumulative dividend of 12% to be paid out of normal profit of the company.
- The inflow from preference issue was utilized to redeem principal portion of loan from associates’ amounting to PKR1.1bln.
- The accrued interest liability of associated loan (PKR 460mln) will be paid after settling the loan of PKR 337mln from financial institutions.

RATING RATIONALE

The ratings recognize the company's leading position in the local H2O2 market, supplemented by efficient production process, sound technological infrastructure, and effective control environment. The ratings draw comfort from DOL's association with a financially sound and experienced business group - DESCON - which has continuously demonstrated support. The planned conversion of company's outstanding liability to associated companies into preference shares signifies the sponsor's strong commitment. The company has significantly improved its operational reliability by introducing reliability centre management. Meanwhile, management's methodical marketing strategy along with service quality helped the company to increase the margin with further penetration in the north region. Furthermore, duty imposed by NTC on anti-dumping, as ratified for medium term bode well for the company's profitability.

KEY RATING DRIVERS

The ratings are dependent on sustained competitiveness of the company. Meanwhile, any deterioration in the overall business dynamics adversely impacting the company's viability would be critical for the ratings. Deemed support of the group is a key consideration.

INDUSTRY SNAPSHOT

H2O2 (Hydrogen Peroxide - HPO), industry presently has two players (a) DOL and (b) Sitara Peroxide (SPOL) with an installed capacity of 30,000 MT each. The domestic demand currently stands close to 55 K tons. Out of the country’s total demand around ~10% is met through imports while the rest is being catered by two players with almost equal share. Current market share of DOL in North region is 50% and the rest is catered by SPOL. In the southern market DOL market share has increased to 80% from 60% and the remaining is covered by SPOL and imports



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DESCON OXYCHEM LIMITED
BALANCE SHEET

	31-Mar-16	30-Jun-15	30-Jun-14	30-Jun-13
	<i>9M</i>	<i>Annual</i>	<i>Annual</i>	<i>Annual</i>
<i>Non-Current Assets</i>	1,895	2,015	2,164	2,301
<i>Investments</i>	-	-	16	25
<i>Inventories</i>	95	104	70	63
<i>Current Assets (Excluding Inventory)</i>	551	535	415	523
Total Assets	2,541	2,653	2,665	2,912
<i>Borrowings</i>	866	1,671	1,738	2,002
Total Liabilities	175	605	430	352
<i>Shareholders' Equity</i>	1,500	377	497	558
Total Liabilities & Equity	2,541	2,653	2,665	2,912

PROFIT & LOSS ACCOUNT

	31-Mar-15	31-Mar-15	30-Jun-14	30-Jun-13
<i>Turnover</i>	1,132	1,409	1,499	1,370
<i>Gross Profit</i>	212	268	299	284
<i>Interest Income</i>	-	-	-	-
<i>Exchange Gain / (Loss)</i>	-	1	(3)	7
Net Income	23	(119)	(61)	(51)

CASHFLOW STATEMENT

	31-Mar-15	31-Mar-15	30-Jun-14	30-Jun-13
<i>EBITDA</i>	251	294	351	377
<i>Free Cashflow from Operations (FCFO)</i>	239	269	337	359
Total Operating Cashflows (TCF)	239	271	337	360
<i>Net Cash available from investing activities</i>	(27)	(8)	(1)	94
<i>Cashflow from financing activities</i>	(166)	(67)	(201)	(159)

RATIO ANALYSIS

	31-Mar-15	31-Mar-15	30-Jun-14	30-Jun-13
<i>Gross Margin</i>	19%	19%	20%	21%
<i>Net Profit Margin</i>	2%	-8%	-4%	-4%
<i>Net Cash Cycle (Days)</i>	37	35	26	27
Total Debt/Total Debt+Equity	37%	85%	81%	81%



STANDARD RATING SCALES & 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	<p>Highest credit quality. Lowest expectation of credit risk.</p> <p>Indicate exceptionally strong capacity for timely payment of financial commitments.</p>	<p>A1+: The highest capacity for timely repayment.</p> <p>A1: A strong capacity for timely repayment.</p> <p>A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.</p> <p>A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.</p> <p>B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.</p> <p>C: An inadequate capacity to ensure timely repayment.</p>
AA+ AA AA-	<p>Very high credit quality. Very low expectation of credit risk.</p> <p>Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.</p>	
A+ A A-	<p>High credit quality. Low expectation of credit risk.</p> <p>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>	
BBB+ BBB BBB-	<p>Good credit quality. Currently a low expectation of credit risk.</p> <p>The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.</p>	
BB+ BB BB-	<p>Moderate risk. Possibility of credit risk developing.</p> <p>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.</p>	
B+ B B-	<p>High credit risk.</p> <p>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>	
CCC CC C	<p>Very high credit risk.</p> <p>“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>	
D	<p>Obligations are currently in default.</p>	

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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’.

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, a suspended 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, or e) the entity/issuer defaults.

Disclaimer: PACRA's rating is 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.



Name of Issuer
Sector
Type of Relationship

Descon Oxychem Limited
Chemicals
Solicited

Purpose of the Rating

Independent Risk Assessment

Rating History

Date	Long Term	Short Term	Outlook	Action
9-Sep-16	A	A1	Stable	Maintain
11-Dec-15	A	A1	Stable	Maintain
12-Dec-14	A	A1	Stable	Maintain
29-Oct-13	A	A1	Stable	Upgrade
2-Nov-12	A	A2	Stable	Maintain
8-Sep-11	A	A2	Stable	Initial

Related Criteria and Research

Rating Methodology
Sector Research

Corporate Rating Methodology
Chemicals - Hydrogen Peroxide | Nov-15

Rating Analysts

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[Rating Team Statement](#)

Rating Procedure

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

[Disclaimer](#)

Rating Shopping

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PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public 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.

Conflict of Interest

PACRA, the analysts involved in the rating process, and members of its rating committee do not have any conflict of interest relating to the credit rating done by them

The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest

The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA

The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees

PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities

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 ii) fee mandate - signed with the payer, which can be different from the entity

PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer

PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so

PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties

Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

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

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