



The Pakistan Credit Rating Agency Limited

Rating Report

Dawood Hercules Corporation 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
25-Jun-2022	AA	A1+	Stable	Maintain	-
25-Jun-2021	AA	A1+	Stable	Maintain	-
26-Jun-2020	AA	A1+	Stable	Maintain	-
27-Dec-2019	AA	A1+	Stable	Maintain	-
28-Jun-2019	AA	A1+	Stable	Maintain	-
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	-

Rating Rationale and Key Rating Drivers

The ratings reflect Dawood Hercules Corporation Limited's ("DH Corp" or "the Company") very strong profile as an investment company with investments in diversified sectors mainly through Engro Corporation Limited ('Engro Corp'). DH Corp has a structured oversight process in place for monitoring and making new investments, an important requisite for any HoldCo. Liquid funds are held in money market instruments indicating strong liquidity. The Company has invested in blue chip market securities to mitigate investment related risks. DH Corp is exploring new investment avenues to add to its portfolio. Lately, the Company invested in the technology led the business through a newly formed wholly owned subsidiary, Empiric AI (Pvt.) Ltd., to provide competitive services in data science, cyber security, and software engineering. The Company continues to receive consistent dividend income from Engro Corp, as the underlying businesses have witnessed substantial growth in each of its business verticals. The Company boasts a very strong financial risk profile owing to strong coverages and significant liquidity showing a robust position. Lately, the Company has loaded short term debt to fund its equity portfolio. However, leveraging remains minimal with largely an equity-based capital structure. Moreover, very strong business acumen of the sponsoring family and strong governance practices provide support to the ratings.

The ratings depend on the management's ability to sustain low risk profile and follow prudent investment policy. At the same time, maintaining a strong financial profile and liquidity remains important. Any significant increase in debt and/or prolonged downturn in invested companies will impact the ratings.

Disclosure

Name of Rated Entity	Dawood Hercules Corporation Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Holding Company Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Holding Company(Aug-21)
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Profile

Background Dawood Hercules Corporation Limited ('DH Corp' or 'the Company') is a listed holding company. In Apr-86, Dawood Group incorporated Dawood Hercules Chemicals Limited. Later in Jan-11, after major restructuring, Dawood Hercules Chemicals Limited demerged its fertilizer operations by establishing a wholly owned subsidiary – DH Fertilizers Limited; while, transforming the Company as a holding company with a changed name as Dawood Hercules Corporation Limited. DH Corp is listed on Pakistan Stock Exchange.

Structural Analysis DH Corp is an investment wing of Dawood Group, with prime focus to manage investments in its subsidiary and associates. The Company's investment book comprise its substantial holding (~37.22%) in Engro Corporation Limited ('Engro Corp'). On May 19, 2020, the Company incorporated a wholly owned subsidiary, Empiric AI (Private) Limited (EMPAK). EMPAK aims to provide globally competitive services in cyber security, data science, software engineering and the full stack of cloud computing.

Ownership

Ownership Structure Dawood Group (Dawood Family and Associates) holds ~34% stake in DH Corp through its' corporate entities (20%) and individuals (14%). Around 54% is held by foreign companies and remaining shares are held by financial institutions, general public and others.

Stability Ownership of the business is seen as stable as major ownership vests with the sponsors (Dawood Family) and HoldCo nature of the Company.

Business Acumen Dawood 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 Group's main investments in Engro Corp are consolidated in DH Corp. In addition, the Group's businesses include Cyan Limited (a listed entity, engaged in making equity investment in companies with high growth potential).

Governance

Board Structure The control of the Company vests with the ten-member Board of Directors. There are six Non-Executive Directors, one Executive Directors and three Independent Directors. The board is dominated by the sponsoring family Majority of the members have long association with the Company.

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

Board Effectiveness BoD has constituted 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 committees remain an important medium through which strategic matters of DH Corp and its investments are brought to the BoD.

Transparency DH Corps' External Auditors are A.F. Ferguson & Co. They issued an unqualified auditor's report on financial statements CY21.

Management

Organizational Structure The Company operates through six departments namely: a) Investment, b) Finance, c) Human Resource, d) Communications, e) Information Technology and f) Internal Audit. All department heads report to the CEO, who reports to the BoD.

Management Team The CEO DH Corp, Mr. Mohammad Shamooin Chaudhry joined the Company in October, 2019. He has more than 25 years of progressive and varied experience in the financial sector and has previously been serving as the CFO.

Management Effectiveness Key members of DH Corp's Board are also present on the Board of their investee companies. This helps exercise effective oversight and control. 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 Previously, the Internal Audit Function of DH Corp was outsourced to Ernst & Young Ford Rhodes Chartered Accountants. Now, the Company has an in-house internal audit department headed by Certified Internal Control Auditor (CIA).

Investment Strategy

Investment Decision-Making The Company has established 4-member investment committee at Board level, which is chaired by a Non-Executive Director, and includes three Independent Directors. The Company's CFO serves as the secretary to the Board Investment Committee. Investments decisions are originated and discussed during the meetings of the committee and then presented to the Company's Board.

Investment Policy The Company has conservative investment policy as their primary investment is Engro Corp (63% of total investments). Diversified pool of investments exists at subsidiary level through Engro Corp which has invested in various sectors i.e., fertilizer, chemicals, banking, energy, and petroleum.

Investment Committee Effectiveness The Board Investment Committee meets on quarterly basis to discuss the existing investments portfolio along with potential new investments. Extensive experience of the members of the committee and senior management's association with the committee provides the required oversight for effective management of the investment portfolio.

Business Risk

Diversification DH Corp's total long-term investment book comprises only two investments i.e., Engro Corporation Limited and Empiric AI (Pvt) Limited. However, Dawood Groups' main investments lie in Engro Corp. On the group level, the investments are diversified into various sectors including Food, Fertilizers, Petrochemicals, Energy, Information Technology, Terminal Services and Telecommunication Infrastructure.

Portfolio Assessment The Company's long-term investment in listed subsidiary Engro Corporation Limited (63% of total investments), and short-term investments in listed scrips and debt securities (37% of total investments) dominate the portfolio. Engro Corp's revenue majorly comprises of consistent dividend income from its subsidiaries. Empiric AI aims to provide globally competitive services in cyber security, data science, software engineering and the full stack of cloud computing and is yet to begin its operations.

Income Assessment Total investment income of the Company stood at ~PKR 6bln during CY21 (CY20: ~PKR 7bln). The decline is primarily attributable to lower interest income and unrealized losses on quoted shares. However, minimal finance costs and effective cost management, the Company posted increase in net income which clocked at ~PKR 4bln during CY21 compared to ~PKR 3.7bln during CY20. During 1QCY22, the Company's total investment income stood at ~PKR 389mln (1QCY21: ~PKR 327mln) and net income stood at ~PKR 109mln (1QCY21: PKR 7mln) witnessing increase attributable to effective management of expenses.

Financial Risk

Coverages In CY21, the Company's Total Operating Cashflows stood at ~PKR 4.3bln (CY20: ~PKR 4.4bln) and finance cost stood at ~PKR 143mln (CY20: ~PKR 1,019mln) resulting in improved interest coverage ratio of 30.3x (CY20: 4.3x) and debt coverage ratio of 28.1x (CY20: 4.2x). In 1QCY22, the interest coverage ratio and debt coverage stood at 3.3x and 3.2x, respectively compared to 1QCY21 where negative Total Operating Cashflows led to negative coverage and debt coverage ratio.

Capital Structure DH Corp had issued two sukuk of PKR 5.2bln and PKR 6bln bearing 3MK+1% profit rate with maturity of Nov-22 and Feb-23, respectively. However, the Company with the approval of BOD has repaid both sukuk in March-21. As at 1QCY22, the leveraging ratio stood at to 18% (CY21: ~18%, CY20: ~19%).

Consolidated Position DH Corp's consolidated borrowings stood at ~PKR 271bln as at CY21 (CY20: ~PKR 233bln) against consolidated equity base of ~PKR 254bln (CY20: PKR ~224bln) translating into consolidated leveraging of ~50.9% (CY20: ~49.1%).



The Pakistan Credit Rating Agency Limited

Dawood Hercules Corporation
Holding Company

	Mar-22	Dec-21	Mar-21	Dec-20
	3M	12M	3M	12M
	Unaudited	Audited	Unaudited	Audited
A BALANCE SHEET				
1 Investments	13,845	13,531	7,574	13,851
2 Related Party Investments	23,721	23,719	23,586	23,597
3 Non-Current Assets	64	68	92	95
4 Current Assets	233	297	487	1,628
5 Total Assets	37,862	37,614	31,740	39,172
6 Current Liabilities	834	658	575	706
7 Borrowings	6,504	6,506	41	7,361
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	6	43	115	103
10 Net Assets	30,517	30,408	31,009	31,002
11 Shareholders' Equity	30,517	30,408	31,009	31,002
B INCOME STATEMENT				
1 Total Investment Income	389	6,013	327	6,970
a Cost of Investments	(144)	(143)	(90)	(1,019)
2 Net Investment Income	246	5,869	238	5,951
a Other Income	2	9	6	10
b Operating Expenses	(74)	(998)	(205)	(1,036)
4 Profit or (Loss) before Interest and Tax	174	4,880	38	4,924
a Taxation	(64)	(899)	(31)	(1,196)
6 Net Income Or (Loss)	109	3,981	7	3,728
C CASH FLOW STATEMENT				
a Total Cash Flow	464	4,288	(44)	4,380
b Net Cash from Operating Activities before Working Capital Changes	413	4,135	(196)	3,350
c Changes in Working Capital	152	(66)	(32)	(23)
1 Net Cash (Used in) or Available From Investing Activities	566	4,069	(228)	3,327
2 Net increase (decrease) in long term borrowings	(914)	(5,282)	6,073	4,205
3 Net Cash (Used in) or Available From Financing Activities	(1)	(11,975)	(7,362)	(6,471)
4 Net Cash generated or (Used) during the period	(350)	(13,189)	(1,516)	1,062
D RATIO ANALYSIS				
1 Performance				
a Asset Concentration (Market Value of Largest Investment / Market Value of)	80.5%	81.1%	88.6%	82.5%
b Core Investments / Market Value of Equity Investments	80.6%	81.2%	88.7%	82.7%
c Marketable Investments / Total Investments at Market Value	16.4%	15.2%	10.0%	7.5%
2 Coverages				
a TCF / Finance Cost	3.3	30.3	-0.5	4.3
b TCF / Finance Cost + CMLTB	3.2	28.1	-0.5	4.2
c Loan to Value (Funding / Market Value of Equity Investments)	0.1	0.1	0.0	0.1
3 Capital Structure (Total Debt/Total Debt+Equity)				
a Leveraging [Funding / (Funding + Shareholders' Equity)]	17.6%	17.6%	0.1%	19.2%
b (Funding + Off Balance Sheet Exposure) / Shareholders' Equity	21.3%	21.4%	0.1%	23.7%

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
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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-	
CCC	
CC	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	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	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>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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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- (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 | Clause 11-(A)(p).
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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)
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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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