



The Pakistan Credit Rating Agency Limited

Rating Report

Dawood Hercules Corporation Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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	-
12-Jan-2016	AA-	A1+	Stable	Upgrade	-

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 Corp. DH Corp has 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 exposing it to market volatility. DH Corp is exploring new investment avenues to add to its portfolio. Last year, the Company has invested into technology led business through a newly formed wholly owned subsidiary, Empiric AI (Pvt.) Ltd., to provide competitive services in data science, cyber security and software engineering. In addition, the Company has received significant dividend from its subsidiary i.e., Engro Corporation Limited ('Engro'), as the underlying businesses managed healthy performance despite challenging environment post Covid-19 outbreak. Early repayment of debt instruments (Sukuk) has strengthen the Company's financial profile. Moreover, strong coverages and significant liquidity shows robust position. 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 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 Corporate Ratings(Jun-20),Methodology Holding Company(Jun-20),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria Rating Modifier(Jun-20)
Related Research	Sector Study Holding Company(Aug-20)
Rating Analysts	Faiqa Qamar faiqa.qamar@pacra.com +92-42-35869504



Profile

Legal Structure Dawood Hercules Corporation Limited ("DH Corp" or "The Company") is a public limited company listed on the Pakistan Stock Exchange (PSX).

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 de-merged its fertilizer operations by establishing a wholly owned subsidiary – DH Fertilizers Limited. Ultimately, Dawood Hercules Chemicals Limited was renamed as 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 food, fertilizers, petrochemicals, energy, information technology, terminal Services and telecommunication Infrastructure. The registered office of the Company is in Karachi.

Ownership

Ownership Structure Dawood Group (Dawood Family and Associates) holds ~33% stake in DH Corp through its' corporate entities (~20%) and individuals (~13%). 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. 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). DH Corp has a strong consolidated asset base of ~PKR 601bln (CY19: ~PKR 574bln) supported by an equity base of ~ PKR 232bln in CY20 (CY19: ~PKR 208bln) signifying a robust strength. Consolidated revenue stood at ~PKR 249bln in CY20 (CY19: ~PKR 226bln) and PAT at ~PKR 43bln in CY20 (CY19: ~PKR 30bln).

Governance

Board Structure The control of the Company vests with the ten-member Board of Directors. There are six Non- Executive Directors including a female Director, one Executive Directors and three Independent Directors. Majority of the members have long association with the Company's Board.

Members' Profile The BoD 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 non-profit ventures. All members are seasoned professionals with experience in energy, chemical, technology and financial sectors, bringing a diverse range of requisite skills to the BoD.

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. During CY20, the Audit Committee met four times, HR&RC Committee five times and investment committee two times. Strong governance framework bodes well for the Company.

Financial Transparency DH Corps' External Auditors are A.F. Ferguson & Co. They issued an unqualified auditor's report on financial statements CY20.

Management

Organizational Structure The Company operates through seven departments namely: a) Investment, b) Finance, c) Human Resource, d) Services and Protocol, e) Information Technology, f) Internal Audit and g) Internal Network & Communication. All heads report to the CEO, who reports to the BoD. However, the Head of Internal Audit Department and Human Resource Department report administratively to the CEO and functionally to Board Audit Committee and Human Resource & Remuneration Committee, respectively.

Management Team Mr. Inam-Ur-Rehman, is serving as CEO since Dec-16. Before joining DH Corp, he was the CEO of Dawood Lawrencepur Limited, Reon Limited and Tenaga Generasi Limited. Mr. Muhammad Shamoony Chaudhry, CFO, 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. This helps exercise effective 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 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).

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 prominent position in the universe of Holding Companies in Pakistan. The Company has investments in various sectors mainly through Engro Corp. The fertilizer business is the second largest producer in its sector in Pakistan. The PVC business is the sole producer of PVC in Pakistan. The dairy business is the market leader in Pakistan's UHT market and number 2 dairy dessert brand serving over 12 million consumers. The Company operates Pakistan's first LNG receiving terminal, and an 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 dividend income from its investee company i.e., Engro Corporation Limited. On a standalone basis, the top-line of the Company stood at ~PKR 5.4bln in CY20 (CY19: ~PKR 5.3bln). The stable dividend income from investee company depicts strong financial muscle. In 1QCY21, the Company has received no dividend income from Engro Corporation just like the corresponding periods. On consolidated basis, the Company posted a revenue of PKR 249bln in CY20 and PKR 71bln in 1QCY21 posting an increase of ~10% and ~58%, respectively.

Margins Margins are a function of the Company's finance cost and taxation. Finance cost decreased by ~28% amounting to ~PKR 1bln in CY20 (9MCY19: ~PKR 1.4bln) owing to lower KIBOR rate. The bottom-line stood at ~PKR 3.7bln (CY19: ~PKR 4.8bln) with very strong net margin of ~53% (CY19: ~58%). In 1QCY21, the net margin stood at ~2% primarily attributable to no dividend income from Engro Corp.

Sustainability DH Corp has a diversified and resilient investment portfolio that can sustain potential shocks in economy. The Company is keeping a close watch on its needs to stay agile and proactive. Lately, the Company incorporated a wholly owned subsidiary i.e., Empiric AI (Pvt.) Limited to penetrate in technology and data science industry. In addition, through Engro Corp, the Company is further diversifying its business as it intends to establish Pakistan's first polypropylene resin manufacturing plant, which is currently in the feasibility stage.

Financial Risk

Working Capital The Company, being a holding company, has limited/ no working capital needs in line with its operations. The Company holds sizeable liquid investment with short term investments of ~PKR 7.6bln in the form of government securities and listed equities with no short term borrowings in 1QCY21.

Coverages In 1QCY21, the Company's Total Operating Cashflow turned negative (1QCY21: ~PKR 44mln, CY20: ~PKR 4.4bln, CY19: ~PKR 5.4bln) due to no dividend income. Resultantly, the debt coverage ratio stood at ~0.5x (CY20: 4.2x, CY19: 3.7x). The Company holds significant liquid investments, providing sizeable cushion against unforeseen contingencies.

Capitalization 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 made an early repayment of the two sukuk on its balance sheet in March-21. As a result, the leveraging decreased significantly to 0.1% in 1QCY21 (CY20: ~19%, CY19: ~23%). DH Corp's consolidate borrowings stood at ~PKR 216bln in 1QCY21 (CY20: ~PKR 228bln, CY19: ~PKR 239bln), translating into a leveraging of ~47% (CY20: ~50%, CY19: ~54%).



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Financial Summary
PKR mln

Dawood Hercules Corporation Limited Holding Company	Mar-21	Dec-20	Mar-20	Dec-19	Dec-18
	3M	12M	3M	12M	12M
	Management	Audited	Management	Audited	Audited
A BALANCE SHEET					
1 Investments	7,574	13,851	14,935	17,979	21,742
2 Related Party Investments	23,586	23,597	23,309	23,309	23,309
3 Non-Current Assets	92	95	300	167	137
4 Current Assets	487	1,628	1,544	803	2,146
5 Total Assets	31,740	39,172	40,088	42,258	47,334
6 Current Liabilities	575	706	999	959	1,258
7 Borrowings	41	7,361	8,997	9,590	11,106
8 Related Party Exposure	-	-	-	-	-
9 Non-Current Liabilities	115	103	5	105	6
10 Net Assets	31,009	31,002	30,087	31,604	34,964
11 Shareholders' Equity	31,009	31,002	30,087	31,604	34,964
B INCOME STATEMENT					
1 Total Investment Income	327	6,970	(1,027)	8,378	5,831
a Cost of Investments	(90)	(1,019)	(347)	(1,425)	(883)
2 Net Investment Income	238	5,951	(1,374)	6,953	4,948
a Other Income	-	-	0	-	3,543
b Operating Expenses	(199)	(1,026)	(256)	(859)	(1,016)
4 Profit or (Loss) before Interest and Tax	38	4,924	(1,631)	6,094	7,475
a Taxation	(31)	(1,196)	114	(1,272)	(1,421)
6 Net Income Or (Loss)	7	3,728	(1,517)	4,822	6,054
C CASH FLOW STATEMENT					
a Total Cash Flow	(44)	4,380	282	5,389	3,317
b Net Cash from Operating Activities before Working Capital Changes	(196)	3,350	(73)	4,033	2,494
c Changes in Working Capital	(32)	(23)	11	1,346	222
1 Net Cash provided by Operating Activities	(228)	3,327	(62)	5,379	2,716
2 Net Cash (Used in) or Available From Investing Activities	6,073	4,205	4,007	4,553	(3,572)
3 Net Cash (Used in) or Available From Financing Activities	(7,362)	(6,471)	(610)	(9,830)	862
4 Net Cash generated or (Used) during the period	(1,516)	1,062	3,335	102	7
D RATIO ANALYSIS					
1 Performance					
a Asset Concentration (Market Value of Largest Investment / Market Value of	31.8%	28.6%	30.8%	36.9%	30.4%
b Core Investments / Market Value of Total Investments	37.2%	38.6%	44.9%	48.2%	37.8%
c Marketable Investments / Total Investments	22.3%	17.7%	16.8%	18.2%	34.9%
2 Coverages					
a TCF / Finance Cost	-0.5	4.3	0.8	3.8	3.8
b TCF / Finance Cost + CMLTB	-0.5	4.2	0.8	3.7	3.8
c Loan to Value (Funding / Market Value of Total Investments)	0.0	0.1	0.1	0.1	0.1
3 Capital Structure (Total Debt/Total Debt+Equity)					
a Leveraging [Funding / (Funding + Shareholders' Equity)]	0.1%	19.2%	23.0%	23.3%	24.1%
b (Funding + Off Balance Sheet Exposure) / Shareholders' Equity	0.1%	23.7%	29.9%	30.3%	31.8%

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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- (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.
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- (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)
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- (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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