



The Pakistan Credit Rating Agency Limited

DESCON OXYCHEM LIMITED

	NEW [JUNE-17]	PREVIOUS [SEP-16]
Long-Term	A	A
Short-Term	A1	A1
Outlook	Stable	Stable

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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 (~55%) through associated companies (~17%) and sponsoring family members (~38%).
- 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. Razak 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 FY16, 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 9MFY17 the topline of company improved (9MFY17: ~PKR 1,497mln; 9MFY16: ~PKR 1,132mln) backed by the increased selling price with largely stable volumes.
- Gross profit of the company witnessed improvement (9MFY17: ~PKR 418mln; 9MFY16: ~PKR 212mln) driven by improved selling prices contributed by increase in underlying price and geographical mix, a complete realignment of marketing strategy.
- Improved topline, better performance management and controlled finance cost elevated the net profit as the bottom-line of the company ended green (9MFY17: ~PKR 174mln; 9MFY16: ~PKR 23mln).
- Going forward, DOL is eyeing to evaluate number of options for manufacturing capacity expansion actively, which will enable the business to provide stronger and seamless supply chain to all its customers domestically.

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 90 days by its sourcing partners.
- The Company’s cash flows remain a function of its profitability. During 9MFY17, DOL’s Cash flows improved on account of superior profits.
- During the period, company’s coverages improved on account of settlement of its long-term borrowings.
- DOL currently has a debt free capital structure (FY16: 22%).
- 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 company has an accrued interest liability amounting to ~PKR 291mln related to Financial Institutions and Associated companies

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 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, anti-dumping duty imposed by NTC bodes well for the company's profitability. Current debt free capital structure of the company strengthens its financial risk profile.

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. Prudent management of new borrowings related to expansion, thereby impacting coverages, is important.

INDUSTRY SNAPSHOT

H2O2 (Hydrogen Peroxide - HPO), industry presently has two players (a) DOL and (b) Sitara Peroxide (SPL) with an installed capacity of 30,000 MT each. The domestic demand currently stands close to 60 K tons. Out of the country's total demand ~10% is met through imports while the rest is being catered by two players i.e. DOL and SPL. Current market share of DOL in North region is 55% and the rest is catered by SPL. In the southern market DOL market share is 44% and the remaining is equally covered by SPL and imports.



BALANCE SHEET	31-Mar-17 9MFY17	30-Jun-16 FY16	30-Jun-15 FY15	30-Jun-14 FY14
Non-Current Assets	1,634	1,836	2,016	2,164
Investments (incl. Associates)	-	-	-	-
Equity	-	-	-	-
Debt Securities (incl. income funds)	-	-	-	-
Current Assets	560	712	638	485
Inventory	24	33	104	70
Trade Receivables	108	54	89	82
Others	428	625	446	333
Total Assets	2,195	2,547	2,654	2,649
Debt/Borrowings	-	407	1,262	1,330
Short-Term	-	50	52	60
Long-Term (incl. Current Maturity of Long-Term Debt)	-	357	1,210	1,270
Other Short-Term Liabilities	508	628	182	142
Other Long-Term Liabilities	-	-	833	697
Shareholder's Equity	1,687	1,513	377	497
Total Liabilities & Equity	2,195	2,547	2,654	2,666
INCOME STATEMENT				
Turnover	1,497	1,582	1,409	1,499
Gross Profit	418	343	268	299
Other Income	(8)	9	6	8
Financial Charges	(11)	(77)	(212)	(225)
Net Income	174	45	(119)	(61)
Cash Flow Statement				
Free Cash Flows from Operations (FCFO)	440	384	269	337
Net Cash changes in Working Capital	(32)	34	(38)	(14)
Net Cash from Operating Activities	225	366	145	202
Net Cash from Investing Activities	(4)	(44)	(8)	(1)
Net Cash from Financing Activities	(407)	(175)	(67)	(201)
Net Cash generated during the period	(186)	146	70	(0)
Ratio Analysis				
Performance				
Turnover Growth (v.s same period last year)	32.3%	12.2%	-6.0%	9.4%
Gross Margin	27.9%	21.7%	19.0%	20.0%
Net Margin	11.6%	2.8%	-8.4%	-4.1%
ROE	14.5%	4.8%	-27.2%	-11.6%
Coverages				
Debt Service Coverage (times) (FCFO/Gross Interest+CMLTD+Uncovered STB)*	40.8	1.2	0.7	1.4
Interest Coverage (times) (FCFO/Gross Interest)	40.8	5.0	1.3	1.5
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO - Gross Int)	0.0	1.2	35.4	18.7
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	12	27	37	28
Leveraging (Total Debt/Total Debt+Equity)**				
	0.0%	21.2%	84.6%	81.2%

**Total Debt = Long-Term Debt + Short-Term Debt



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
AAA AA+ AA AA- A+ A A-	<p>Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.</p> <p>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.</p> <p>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.</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>
BBB+ BBB BBB-	<p>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.</p>	
BB+ BB BB-	<p>Speculative. Possibility of credit risk developing. 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-	<p>Highly speculative. Significant 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.</p>	
CCC CC C	<p>High default 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.</p>	
D	<p>Obligations are currently in default.</p>	

<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 with in foreseeable future, but may continue if underlying circumstances are not settled.</p>	<p>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’.</p>	<p>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.</p>	<p>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.</p>
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Name of Issuer Descon Oxychem Limited
Sector Chemicals
Type of Relationship Solicited
Purpose of the Rating Independent Risk Assessment

Rating History

Date	Long Term	Short Term	Outlook	Action
30-Jun-17	A	A1	Stable	Maintain
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 Corporate Rating Methodology
Sector Research Chemicals - Hydrogen Peroxide | June-17

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Rating Team Statement
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