



The Pakistan Credit Rating Agency Limited

# DAWOOD HERCULES CORPORATION LIMITED

## INSTRUMENT RATING REPORT

|   | PRELIMINARY<br>[OCT-17] | REPORT CONTENTS  |
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OCTOBER 2017

### About the Sukuk

- DH Corp, plans to issue an over the counter listed and secured Sukuk of PKR 6bln inclusive of green shoe option of PKR 1bln.
- With a tenor of 5 years, the Sukuk's profit (3-M Kibor + 1%) will be paid in 4 equal quarterly installments, starting from the 3<sup>rd</sup> month of issue date. Whereas principal will be re-paid in 8 semi-annual payments starting from 18<sup>th</sup> month from the issue date.
- The instrument is secured with pledge of shares of Engro Corporation Limited, inclusive of 50% margin, in a designated CDC account and Floating or Hypothecation charge on all present and future assets of the Company inclusive of a 25% margin.

### About the Company

- Dawood Hercules Corporation is a public listed company incorporated in 1968. The principal activities of the company is to manage the investments in its subsidiary and associated companies.
- The Dawood Hercules Group (DHG) comprises Dawood Hercules Corporation Limited, Engro Corporation Limited and its associate concerns i.e. Hub Power Company Limited.

### Governance & Management

- The board of directors comprises ten (nine elected directors and one deemed director) experienced member. The board comprises of four representatives of the DG and the remaining five members are non-executive 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. Inam-ur-Rahman (deemed director) leads the company as CEO.

### Performance

- DH Corp's standalone income comprises dividend income received from its subsidiary and associates. The major source of dividend is ECORP which accounts for 70% of the dividend received by the company.
- The dividend income for 1HCY17 clocked in at PKR 2,358mln compared to PKR 3,720mln in 1HCY16. The decline is mainly due to lower dividend from HUBCO.
- The dividend income of DH Corp is expected to decline post HUBCO divestment.
- The company managed decline in operating expenses (1HCY17: PKR 258mln, 1HCY16: PKR 409mln) due to onetime fee paid to McKinsey & Co. Finance cost however, registered an increase of 35% (1HCY17: PKR 229mln). Overall profitability declined by 47.25% to PKR 1,384mln in 1HCY17.

### Investments

- DH-Corp has a portfolio of investments mainly classified as subsidiary or associates. It has one subsidiary, ECORP (37.22% ownership) and associates, HUBCO (14.91% ownership).
- DHG's consolidated investment book was worth PKR 37.4bln at end-June-17. The market value of its consolidated investments was at ~ PKR. 84bln as at end-June-17.
- The investment in HUBCO has been classified as Held for Sale pursuant to the board's decision for potential sales of entire investment in the company.
- During the year DH Corp together with edotco Group Sdn Bhd ("edotco"), announced to acquire approximately 13,000 telecommunication towers from Pakistan Mobile Communications Limited.
- As a part of the transaction, DH Corp will be investing a 45% equity stake with the remaining 55% control stake to be held by edotco. The total transaction consideration for the proposed acquisition is USD 940mln, funded through a combination of debt and equity.

### Financial Risk

- DH Corp, has a low leveraged capital structure. As of June-17, the current long term debt of the company stands at PKR 2.5bln and short term debt of PKR 3.8bln.
- The company plans to issue an over the counter listed and secured Sukuk of PKR 6bln inclusive of green shoe option of PKR 1bln. With a tenor of 5 years, 3-M Kibor + 1% as profit. The proceeds will be used to merge and re-profile the existing debt.

### RATING RATIONALE

The ratings signify Dawood Hercules Corporation Limited's (DH Corp) strong group structure and a well-diversified presence in various industries through associates and subsidiaries. The oversight of investments is done through a structured process, an important pillar of which is the analytical team. The company is currently transforming its investment portfolio. The transformation process includes divestment in energy sector (Hub Power Company Limited) and utilizing the proceeds to penetrate telecommunication sector by acquiring 45% equity stake in edotco Pakistan (Pvt.) Limited. DH Corp's financial profile continues to benefit from the ensuing dividend stream of the underlying portfolio – core & strategic Investments. However, post divestment, dividend income is expected to slightly decline until the new investment starts to distribute income. The rating draws comfort from company's low leverage and good debt coverages. The company plans to issue a Sukuk to re-profile its current debt structure – short and long term debt – which will benefit the financial risk profile. The Sukuk has a low risk profile as it is secured through a charge on the shares of the company core investment inclusive of 50% margin. 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 management's policy to distribute its income, while maintaining a strong financial risk would be critical. Timely and successful investment transition also remains important for the ratings.



**Dawood Hercules Corporation Limited (DHCL)**

| BALANCE SHEET   | 30-Jun-17<br>IH CY17 | 30-Dec-16<br>Annual | 30-Dec-15<br>Annual | 31-Dec-14<br>Annual |
|---|----------------------|---------------------|---------------------|---------------------|
| <b>Non-Current Assets</b>                               | <b>165</b>           | <b>126</b>          | <b>133</b>          | <b>78</b>           |
| <b>Investments (Incl. associates)</b>                   | <b>37,478</b>        | <b>37,478</b>       | <b>37,574</b>       | <b>20,570</b>       |
| Equity  | 37,478               | 37,478              | 37,574              | 20,570              |
| Debt  | -                    | -                   | -                   | -                   |
| <b>Current Assets</b>                                   | <b>67</b>            | <b>347</b>          | <b>1,164</b>        | <b>35</b>           |
| Inventory   | -                    | -                   | -                   | -                   |
| Trade Receivables                                       | -                    | -                   | -                   | -                   |
| Others  | 67                   | 347                 | 1,164               | 35                  |
| <b>Total Assets</b>                                     | <b>37,710</b>        | <b>37,950</b>       | <b>38,871</b>       | <b>20,858</b>       |
| <b>Debt</b>   | <b>6,278</b>         | <b>6,758</b>        | <b>4,424</b>        | <b>766</b>          |
| Short-term  | 2,441                | 2,869               | 432                 | 436                 |
| Long-term (Incl. Current Maturity of long-term debt)    | 3,837                | 3,889               | 3,993               | 330                 |
| Other shortterm liabilities                             | 1,131                | 351                 | 651                 | 233                 |
| Other Longterm Liabilities                              | 1                    | 2                   | -                   | 0                   |
| <b>Shareholder's Equity</b>                             | <b>30,300</b>        | <b>30,839</b>       | <b>33,795</b>       | <b>19,858</b>       |
| <b>Total Liabilities &amp; Equity</b>                   | <b>37,710</b>        | <b>37,950</b>       | <b>38,871</b>       | <b>20,858</b>       |
| <b>INCOME STATEMENT</b>                                 |                      |                     |                     |                     |
| <b>Turnover</b>   | <b>2,359</b>         | <b>7,422</b>        | <b>21,932</b>       | <b>1,653</b>        |
| Gross Profit  | 2,100                | 6,675               | 20,642              | 1,241               |
| Other Income  | 1                    | 12                  | 284                 | (84)                |
| Financial Charges                                       | (229)                | (393)               | (219)               | (122)               |
| <b>Net Income</b>                                       | <b>1,384</b>         | <b>5,470</b>        | <b>20,194</b>       | <b>860</b>          |
| <b>Cashflow Statement</b>                               |                      |                     |                     |                     |
| Free Cashflow from Operations (FCFO)                    | (411)                | (1,535)             | (1,668)             | (572)               |
| Net Cash changes in Working Capital                     | (109)                | (152)               | 84                  | (40)                |
| Net Cash from Operating Activities                      | 1,572                | 5,342               | 20,194              | (120)               |
| Net Cash from Investing Activities                      | (82)                 | (9)                 | (16,797)            | 686                 |
| Net Cash from Financing Activities                      | (1,743)              | (6,041)             | (2,138)             | (52)                |
| <b>Ratio Analysis</b>                                   |                      |                     |                     |                     |
| <b>Performance</b>                                      |                      |                     |                     |                     |
| Turnover Growth   | 202.5%               | 45.9%               | 71.6%               | 79.2%               |
| Gross Margin  | 97.0%                | 89.9%               | 94.1%               | 75.1%               |
| Net Margin  | 73.0%                | 73.7%               | 92.1%               | 52.0%               |
| ROE   | 11.2%                | 17.3%               | 58.8%               | 1.5%                |
| <b>Capital Structure</b> (Total Debt/Total Debt+Equity) | 17.2%                | 18.0%               | 11.6%               | 3.7%                |

## CREDIT 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.

| <b>LONG TERM RATINGS</b> |   | <b>SHORT TERM RATINGS</b>   |
|--------------------------|---|---|
| <b>AAA</b>               | <b>Highest credit quality.</b> Lowest expectation of credit risk.<br>Indicate exceptionally strong capacity for timely payment of financial commitments.  | <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>AA+</b>               | <b>Very high credit quality.</b> Very low expectation of credit risk.   |   |
| <b>AA</b>                | Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.   |   |
| <b>AA-</b>               |   |   |
| <b>A+</b>                | <b>High credit quality.</b> Low expectation of credit risk.   |   |
| <b>A</b>                 | 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.  |   |
| <b>A-</b>                |   |   |
| <b>BBB+</b>              | <b>Good credit quality.</b> Currently a low expectation of credit risk.   |   |
| <b>BBB</b>               | 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.   |   |
| <b>BBB-</b>              |   |   |
| <b>BB+</b>               | <b>Moderate risk.</b> Possibility of credit risk developing.  |   |
| <b>BB</b>                | 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.                                  |   |
| <b>BB-</b>               |   |   |
| <b>B+</b>                | <b>High credit risk.</b>  |   |
| <b>B</b>                 | 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>B-</b>                |   |   |
| <b>CCC</b>               | <b>Very high credit risk.</b> Substantial credit risk   |   |
| <b>CC</b>                | “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. |   |
| <b>C</b>                 |   |   |
| <b>D</b>                 | Obligations are currently in default.   |   |

**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, a) some material identifiable event and/or b) deviation from expected trend. 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 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.

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**Regulatory and Supplementary Disclosure**

**Name of Issuer**  
**Name of Issue**  
**Sector**  
**Type of Relationship**

Dawood Hercules Corporation Limited  
 Dawood Hercules Corporation Limited | Sukuk  
 Holding Company  
 Solicited

**Purpose of the Rating**

Independent Risk Assessment

**Rating History**

| Dissemination Date | Rating | Outlook | Action      |
|--------------------|--------|---------|-------------|
| 19-Oct-17          | AA     | Stable  | Preliminary |

**Instrument Details**

| Nature of Instrument | Size of Issue (PKR mln) | Tenor (yrs) | Security   | Nature of Assets               | Investment Agent |
|----------------------|-------------------------|-------------|--|--------------------------------|------------------|
| Sukuk                | PKR 6,000mln            | 5           | <ul style="list-style-type: none"> <li>Pledge of shares of Engro Corporation Limited, inclusive of 50% margin, in a designated CDC account. In the event of any sale and repurchase of security.</li> <li>Floating or Hypothecation charge on all present and future assets of the Company inclusive of a 25% margin.</li> </ul> | Land, building and investments | JS Bank Limited  |

**Amortization Schedule**

Refer to Annexure

**Related Criteria and Research**

Holding Company | Jun-2017

**Rating Methodology**

Corporate Rating Methodology  
 Sukuk Rating Methodology

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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.

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specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. ([www.pacra.com](http://www.pacra.com)). However, actual transition of rating may not follow the pattern

observed in the past

| Month End | Opening Principal | Principal Repayment | Due Date Markup/ Profit | Markup/Profit Rate |        | Profit Payment | Installment Payable | Principal Outstanding |
|-----------|-------------------|---------------------|-------------------------|--------------------|--------|----------------|---------------------|-----------------------|
|           | PKR in mln        |                     |                         | Base               | Spread |                |                     |                       |
| 3rd       | 6,000             | 0                   | 3rd Month               | 3M Kibor           | 100bps | 107            | 107                 | 6,000                 |
| 6th       | 6,000             | 0                   | 6th Month               | 3M Kibor           | 100bps | 107            | 107                 | 6,000                 |
| 9th       | 6,000             | 0                   | 9th Month               | 3M Kibor           | 100bps | 107            | 107                 | 6,000                 |
| 12th      | 6,000             | 0                   | 12th Month              | 3M Kibor           | 100bps | 107            | 107                 | 6,000                 |
| 15th      | 6,000             | 0                   | 15th Month              | 3M Kibor           | 100bps | 107            | 107                 | 6,000                 |
| 18th      | 6,000             | 600                 | 18th Month              | 3M Kibor           | 100bps | 107            | 707                 | 5,400                 |
| 21st      | 5,400             | 0                   | 21st Month              | 3M Kibor           | 100bps | 97             | 97                  | 5,400                 |
| 24th      | 5,400             | 600                 | 24th Month              | 3M Kibor           | 100bps | 97             | 697                 | 4,800                 |
| 27th      | 4,800             | 0                   | 27th Month              | 3M Kibor           | 100bps | 86             | 86                  | 4,800                 |
| 30th      | 4,800             | 600                 | 30th Month              | 3M Kibor           | 100bps | 86             | 686                 | 4,200                 |
| 33rd      | 4,200             | 0                   | 33rd Month              | 3M Kibor           | 100bps | 75             | 75                  | 4,200                 |
| 36th      | 4,200             | 600                 | 36th Month              | 3M Kibor           | 100bps | 75             | 675                 | 3,600                 |
| 39th      | 3,600             | 0                   | 39th Month              | 3M Kibor           | 100bps | 64             | 64                  | 3,600                 |
| 42nd      | 3,600             | 600                 | 42nd Month              | 3M Kibor           | 100bps | 64             | 664                 | 3,000                 |
| 45th      | 3,000             | 0                   | 45th Month              | 3M Kibor           | 100bps | 54             | 54                  | 3,000                 |
| 48th      | 3,000             | 600                 | 48th Month              | 3M Kibor           | 100bps | 54             | 654                 | 2,400                 |
| 51st      | 2,400             | 0                   | 51st Month              | 3M Kibor           | 100bps | 43             | 43                  | 2,400                 |
| 54th      | 2,400             | 1,200               | 54th Month              | 3M Kibor           | 100bps | 43             | 1243                | 1,200                 |
| 57th      | 1,200             | 0                   | 57th Month              | 3M Kibor           | 100bps | 21             | 21                  | 1,200                 |
| 60th      | 1,200             | 1,200               | 60th Month              | 3M Kibor           | 100bps | 21             | 1221                | 0                     |