



The Pakistan Credit Rating Agency Limited

# DAWOOD HERCULES CORPORATION LIMITED

## INSTRUMENT RATING REPORT

	PRELIMINARY [DEC-17]	REPORT CONTENTS
Over the counter Listed & Secured Sukuk issue of PKR 7,000mln	AA	1. SUMMARY REPORT 2. FINANCIAL SUMMARY 3. RATING SCALE
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DECEMBER 2017

### About the Sukuk

- DH Corp, plans to issue an over the counter listed and secured Sukuk of PKR 7bln inclusive of green shoe option of PKR 2bln.
- 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.
- The company issued a similar instrument in November, an over the counter listed and secured Sukuk of PKR 6bln inclusive of green shoe option of PKR 1bln. The company managed to raise PKR 5.2bln.

### 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 and 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 9MCY17 clocked in at PKR 3,724mln compared to PKR 5,085mln in 9MCY16. The decline is mainly due to lower dividend from HUBCO.
- The dividend income is expected to remain stable until the divestment of HUBCO.
- The company managed to reduce its operating expenses (9MCY17: PKR 363mln, 9MCY16: PKR 544mln) due to onetime fee paid to McKinsey & Co. Finance cost however, registered and increase of 40% (9MCY17: PKR 358mln). Overall profitability declined by 35.8% to PKR 2,311mln in 9MCY17.

### Investments

- DH-Corp has a portfolio of investments mainly classified as subsidiary or associates. It has one subsidiary, ECORP (37.22%) and associates, HUBCO (14.91%).
- DHG's consolidated investment book was worth PKR 37.4bln at end-Sep-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. The sale of HUBCO has been called off and accordingly the investment is reclassified as long term investment.
- 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

- As of Sep-17, the current long term debt of the company stands at PKR 2.5bln and short term debt of PKR 6.3bln. The company has raised PKR 5.2bln in the first issue and plans to raise PKR 7bln more in the second Sukuk issue. The total proceeds from both Sukuks will be used to re-profile the total debt of PKR 8.7bln at end Sep-17. Remaining proceeds along with a planned syndicate loan, with maturity of 5 year, will be used to finance the equity portion in edotco.
- Management plans to retire the syndicate loan early, pursuant to divestment in the HUBCO shares.
- Company's interest coverage ratio based on cash flow is 4.9x as of Sep-17. Interest coverage is expected to deteriorate however, the company is expected to manage interest payments in future.

### RATING RATIONALE

The ratings signify DH Corp's 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. The company is setting its foot in the telecommunication sector by acquiring 45% equity stake in edotco Pakistan (Pvt.) Limited. The company would be managing a portfolio of telcom towers. Since this portfolio is being acquired from a telco, edotco should be able to manage this -operationally rather swiftly. DH Corp's financial profile continues to benefit from the ensuing dividend stream of the underlying portfolio – mainly Engro Corp and HUBCO. The company intends to divest HUBCO. However, its divestiture would be planned in a way either repay the debt significantly or match expected inflow of dividends from edotco. This would ensure limited drag on financial profile. The rating draws comfort from company's adequate leverage and good debt coverages. To fund its investment in edotco, DH Corp plans to issue a second Sukuk along with a syndicate loan. The Sukuk has a low risk profile as it is secured through a charge on the shares of the company's 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 policy to distribute its income, while maintaining a strong financial risk would be critical. Timely and successful investment transition remains important.



**Dawood Hercules Corporation Limited (DHCL)**

BALANCE SHEET	30-Sep-17 9M CY17	30-Dec-16 Annual	30-Dec-15 Annual	31-Dec-14 Annual
<b>Non-Current Assets</b>	<b>164</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>3,083</b>	<b>347</b>	<b>1,164</b>	<b>35</b>
Inventory	-	-	-	-
Trade Receivables	-	-	-	-
Others	3,083	347	1,164	35
<b>Total Assets</b>	<b>40,726</b>	<b>37,950</b>	<b>38,871</b>	<b>20,858</b>
<b>Debt</b>	<b>8,771</b>	<b>6,758</b>	<b>4,424</b>	<b>766</b>
Short-term	5,021	2,869	432	436
Long-term (Incl. Current Maturity of long-term debt)	3,750	3,889	3,993	330
Other shortterm liabilities	727	351	651	233
Other Longterm Liabilities	2	2	-	0
<b>Shareholder's Equity</b>	<b>31,226</b>	<b>30,839</b>	<b>33,795</b>	<b>19,858</b>
<b>Total Liabilities &amp; Equity</b>	<b>40,726</b>	<b>37,950</b>	<b>38,871</b>	<b>20,858</b>
<b>INCOME STATEMENT</b>				
<b>Turnover</b>	<b>3,724</b>	<b>7,422</b>	<b>21,932</b>	<b>1,653</b>
Gross Profit	3,360	6,675	20,642	1,241
Other Income	1	12	284	(84)
Financial Charges	(358)	(393)	(219)	(122)
<b>Net Income</b>	<b>2,311</b>	<b>5,470</b>	<b>20,194</b>	<b>860</b>
<b>Cashflow Statement</b>				
Free Cashflow from Operations (FCFO)	(607)	(1,535)	(1,668)	(572)
Net Cash changes in Working Capital	(1,771)	(152)	84	(40)
Net Cash from Operating Activities	(310)	5,342	20,194	(120)
Net Cash from Investing Activities	(61)	(9)	(16,797)	686
Net Cash from Financing Activities	(2,062)	(6,041)	(2,138)	(52)
<b>Ratio Analysis</b>				
<b>Performance</b>				
Turnover Growth	57.9%	45.9%	71.6%	79.2%
Gross Margin	90.2%	89.9%	94.1%	75.1%
Net Margin	62.1%	73.7%	92.1%	52.0%
ROE	0.0%	17.3%	58.8%	1.5%
<b>Capital Structure</b> (Total Debt/Total Debt+Equity)	21.9%	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. 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.	

<p><b>Outlook (Stable, Positive, Negative, Developing)</b> 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><b>Rating Watch</b> 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.</p>	<p><b>Suspension</b> 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><b>Withdrawn</b> 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, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information</p>
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**Regulatory and Supplementary Disclosure**

**Name of Entity**  
**Sector**  
**Type of Relationship**

Dawood Hercules Corporation Limited  
Holding Company  
Solicited

**Purpose of the Rating**

Independent Risk Assessment

**Rating History**

Dissemination Date	LT Rating	Outlook	Action
30-Dec-17	AA	Stable	Preliminary

**Instrument Details**

Nature of Investment	Size of Issue (PKR Mln)	Tenor (yrs)	Security	Nature of Assets	Investment Agent
Sukuk	PKR 7,000mln	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 Procedure**

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## Dawood Hercules Corporation Limited | Sukuk | Redemption Schedule

Annexure

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	7,000	0	3rd Month	3M Kibor	100bps	125	125	7,000
6th	7,000	0	6th Month	3M Kibor	100bps	125	125	7,000
9th	7,000	0	9th Month	3M Kibor	100bps	125	125	7,000
12th	7,000	0	12th Month	3M Kibor	100bps	125	125	7,000
15th	7,000	0	15th Month	3M Kibor	100bps	125	125	7,000
18th	7,000	700	18th Month	3M Kibor	100bps	125	825	6,300
21st	7,000	0	21st Month	3M Kibor	100bps	113	113	6,300
24th	7,000	700	24th Month	3M Kibor	100bps	113	813	5,600
27th	7,000	0	27th Month	3M Kibor	100bps	100	100	5,600
30th	7,000	700	30th Month	3M Kibor	100bps	100	800	4,900
33rd	7,000	0	33rd Month	3M Kibor	100bps	88	88	4,900
36th	7,000	700	36th Month	3M Kibor	100bps	88	788	4,200
39th	7,000	0	39th Month	3M Kibor	100bps	75	75	4,200
42nd	7,000	700	42nd Month	3M Kibor	100bps	75	775	3,500
45th	7,000	0	45th Month	3M Kibor	100bps	63	63	3,500
48th	7,000	700	48th Month	3M Kibor	100bps	63	763	2,800
51st	7,000	0	51st Month	3M Kibor	100bps	50	50	2,800
54th	7,000	1,400	54th Month	3M Kibor	100bps	50	1,450	1,400
57th	7,000	0	57th Month	3M Kibor	100bps	25	25	1,400
60th	7,000	1,400	60th Month	3M Kibor	100bps	25	1,425	0