



RATINGS (JULY 2011)

DESCON OXYCHEM LIMITED (DOL)

ENTITY	NEW
Long Term	A
Short Term	A2

FINANCIAL DATA

PKR (MLN)

	31-Mar-11*	30-Jun-10	30-Jun-09
Total Assets	3,114.8	3,117.6	3,069.8
Equity	607.2	555.2	844.2
Turnover	1071.5	709.7	191.3
Net Income	52.1	289.4	150.1
Gross Margin (%)	34.6	3.7	n.m
RoE (%)	8.6	(52.5)	(19.7)
Total Debt/Total Debt + Equity (%)	75.6	77.4	67.2

*Based on un-audited accounts for nine months

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RATING RATIONALE AND KEY DRIVERS

▪ 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 management is pursuing a focused strategy to enhance the product awareness, which would give boost to product demand while ensuring sustainable margins. DOL has significant reliance on gas as a basic raw material wherein, though it has relatively small gas needs, this would remain a concern given the prevailing energy shortage in the country. The company's cashflows, in turn coverages, remain adequate against challenges of temporary gas shortage and price fluctuations. Ratings draw comfort from DOL's association with a financially sound and diversified business group – Descon – which in the past has demonstrated support.

▪ The ratings are dependent on the management's ability to sustain its competitive positioning through changing regulatory and competitive scenarios. Meanwhile, any material deterioration in the overall business dynamics adversely impacting the company's cashflows and coverages would remain critical for the ratings.

ASSESSMENT

▪ H₂O₂, a weak acid composed of water and hydrogen gas, is one of the key chemical compounds used in various industrial processes as oxidizing, bleaching and sterilizing agent. There are presently two players (a) DOL and (b) Sitara Peroxide (SPOL) in the country with installed capacity of 30,000 MT each. The domestic demand currently stands close to 65 K tons, of which 10 K tons is imported while the rest is met by the two players (DOL: 55%, SPOL: 45%). Imports are mainly from Korea and Thailand. Textile Industry is the main consumer of H₂O₂ representing more than three-fourth of the total demand, followed by 'Paper & Board' industry.

▪ DOL, with a leading position in the local industry, has the ability to produce two different type of products depending upon the concentration levels, (i) chemical grade (50% concentrated), and (ii) food grade (35% concentrated). Chemical grade component represents above 95% of the production mix. DOL also exports 20% of its total capacity to neighboring countries mainly India, Sri Lanka and the UAE in order to achieve diversity in its sales mix. The company has implemented Oracle e-Business suit for budgeting and accounting purposes.

▪ The company's heavy reliance on gas as a basic raw material generates substantial risk given the prevailing supply shortage of the resource in the country. However, with the installation of a captive gas pipe line to ensure constant gas supply, DOL managed the risk, resulting in increased capacity utilization (~95%) during FY11. At the same time, the recent upsurge in local H₂O₂ prices owing to constrained supply in the international market jacked up DOL's topline. The largely sustained raw material costs due to unchanged gas prices helped in generating healthy margins for the company. Although sizeable finance cost, on account of high leveraging, exerted pressure on the company's bottom line, it managed to achieve nominal profitability for the first time during 9MFY11.

▪ Going forward, the management plans to increase its exports to 30% of the total sales mix, while establishing foot prints in other countries. The breadth of domestic market would be expanded through penetrating potential business segments. The increased demand would be tapped through enhancement in production capacity (90 TPD to 100 TPD). Furthermore, the management strategizes to increase volume of bulk sales in the form of tankers as against small jerry cans with an intention to strengthen the margins.

▪ DOL's short-term borrowings are mainly a function of the company's working capital requirement. DOL previously utilized short-term funding to finance its operational losses. With increase in topline, the company has started generating surplus cash, which is deployed in mutual funds – enabling the company's liquid coverages to improve. Meanwhile, the company's long-term debt payment of ~PKR 220bln on an annual basis remains adequately covered on account of improvement in the DOL's cash generation ability.

▪ DOL currently has a high leveraged capital structure. The company's capital structure (Total Debt/Total Debt + Equity) stands at 75% at end-Mar11. However, comfort can be drawn from the group's subordinated debt amounting to PKR 408mln.

PROFILE

▪ Descon Oxychem Limited (DOL), a green-field project for producing Hydrogen Peroxide (H₂O₂), incorporated in 2004, is listed on Karachi Stock Exchange. The plant started commercial production in Mar09. Descon Group (DG), the principal sponsor of DOL, holds majority shareholding (70%) of DOL through associated companies (29%) and sponsoring family members (31%). DG is a diversified group with a strong foothold in engineering business through its flagship company – Descon Engineering Limited. The group, over the years, has expanded its horizons to Abu Dhabi, Saudi Arabia, Qatar, Oman, and Egypt.

▪ DOL's board, comprising seven-members, is dominated by representatives of DG. Mr. Razzak Dawood - founder and Head of DG - is the Chairman of the board. The CEO of DOL, Mr. Taimur Saeed, recently elevated to this position, holds vast experience of over twenty years in the field of Marketing & Sales in Oil & Gas sector.