MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

I take pleasure in presenting the Annual Report of your Company along with audited Financial Statements (Separate and Consolidated) for the year ended 30 June 2019.

DEAR INVESTORS, CUSTOMERS, PARTNERS, AND EMPLOYEES:

Despite an exceptionally challenging year, Crescent Steel closed the year with a marginally positive profit after tax of Rs. 143 million (FY18: Rs. 752 million) and a contribution to the exchequer and economy aggregating Rs. 1,416 million. On a consolidated basis however, the Group posted a loss of Rs. 419 million (FY 18: Rs. 61 million), owing to losses of Rs. 450 million taken on Crescent Hadeed and CS Energy during the year. Consequently, after nine years, Crescent Steel did not pay any dividends this financial year.

During the year, the primary pain points for business and growth were the slowdown in demand and the rising input costs. As a result of reduced activity and market dynamics most of our manufacturing facilities, with the exception of the spinning unit, remained idle for a significant portion of the year.

As a result, we posted sales of Rs. 4,067 million (FY18: Rs 7,044 million), down 42.2% YoY. On account of idling, higher input costs, gross profit margins fell to 5.4% (FY18: 11.5%), operating profit margin also fell, however was protected by investment income of Rs. 192 million (FY18: Rs. 496 million), constituting primarily of dividend income from strategic investments.

Our trading portfolio trailed KSE-100 returns of negative 19.11%, closing the year at negative 28.49% including a dividend yield of 8.4%. The variance between the trading portfolio and benchmark returns was primarily due to unrealized losses booked on account of working capital needs. Dividend income from strategic investments however, enabled an ROI of 4.6% on the entire portfolio.

EBIT decreased 77.6% to Rs. 269 million (FY18: Rs. 1,203 million), representing a margin on net sales of 6.6% (FY18: 17.1%) while underlying EBITDA totaled Rs 385 million (FY18: Rs. 1,308 million) at a margin of 9.5%. ROCE declined to 3.6% (FY18: 13.9%).

Consequently, the Company EPS for FY19 stood at Rs. 1.85 as against Rs. 9.68 in FY18 and loss per share of Rs. 5.40 and Rs. 0.79 on a consolidated basis in FY19 and FY18, respectively.

Our balance sheet is strong with a footing of Rs. 8,287 million and continues to support our business through a difficult operating environment. This has specially been helpful in the amalgamation of underperforming units Crescent Hadeed and CS Energy and in managing periods of famine in our core business line. Despite turbulent years, the Company book value has grown at a compounded annual growth rate of 7.4% since 1987 to Rs. 69.5 as on 30 June 2019.

The Group bottom line before consolidation adjustments stood at negative Rs. 225 million (FY18: Positive Rs. 487 million), profits from the investments and cotton division were entirely eroded by losses from subsidiary units CSEL and CHPL. Accounting standards require exclusion of dividend income and inclusion of share of profit from associates resulting in a group bottom line of Rs. (419) million after consolidation adjustments. On a group basis underlying EBIT decreased 235.9% to negative Rs. 444 million (FY18: Positive Rs. 326 million) representing a loss on net sales of 6.5%. EBITDA totaled Rs. 189 million representing a margin of 2.8%. This translated into a loss per share of Rs. 5.40 (FY18 LPS: Rs. 0.79). Segment wise performance is covered separately in this report for business units and subsidiaries.

Having stated some fiscal facts, I would now like to move to operations.

The outgoing year witnessed rapidly deteriorating economic indicators and sentiments resulting in challenging business conditions in the face of increasing input costs making it difficult to compete. For us performance depends heavily on the progress of energy and water infrastructure development projects and on domestic growth. Reducing demand, the mismatch between revenues and deficits, Rupee depreciation and increased tariffs causing supply chain costs to go up are hurting business and all our operations were negatively affected by worsening economic conditions.

On 8 June 2019 the Board approved the Scheme of Amalgamation for Crescent Hadeed (Private) Limited (CHL) and CS Energy (Private) Limited (CSEL) with and into the Company. Consequently, as of the completion date of 30 June 2019 both operations stand amalgamated with Crescent Steel.

Energy infrastructure development projects that use pipes has been the single most important contributor to growth and hiring for us in the past. Periods of inactivity were usually buffered by strong capital markets performance; however, the past year has seen a slow down across all our business lines. We managed to produce and supply 12,068 tons of steel line pipe during the year as against 49,828 tons in FY18.

The Cotton Division too continued to face challenges, with respect to competing at this scale of operations, faced with rising input costs and tariff anomalies with regional competitors. The unit produced 9,087,295 Kgs (on basis of 20/1 count). The division posted sales of Rs. 1,685 at a net margin of 4.17 % and contributed Rs. 70 million to the Company's profit before tax. Furthermore, mills are now facing additional liquidity and operational challenges because of the new taxation regime.

Our capital markets segment provided working capital and cash flow support to our core business. The local bourse, however, remained under pressure due to foreign selling of USD 356 million, liquidity pressures, uncertain and weak macro-economic fundamentals, weaker corporate sector performance and increasing fixed income yields leading to a shift of liquidity from equities to fixed income. The division posted a PBT of Rs. 153 million which includes dividend income of Rs. 209 million, realized loss of Rs. 16 million, unrealized loss of Rs. 4 million. Of this, Rs. 191 million constitutes dividend from strategic investments.

Our steel long products business, previously CHL, posted a negative ROE of 46.6% and performance of the power plant also remained dull with the company posting a negative ROE of 7.7%. Sale of power is directly linked to the operations of the steel melt shop and billet manufacturing unit which operated at a capacity utilization of 34.3 % during the year on account of cash flow constraints as well as market dynamics where input costs were on the rise but selling prices of billets did not go up proportionally.

2019 has been another challenging year for us at Crescent Steel and it came with significant changes to business. We took measures to restructure the Company for greater financial efficiency. I feel this was an important step in ensuring that we are more agile and responsive to stakeholder needs. These measures are important in building an entrepreneurial way of working.

I am encouraged by stronger future growth prospects, continuity of reforms and improved governance bringing benefits for business as the effects of recent policy measures settle down. We expect market conditions to remain challenging and for demand to remain sluggish over the next fiscal year, before thigs begin to improve. We do not expect much progress on public sector development projects in the short term and so demand for line pipes is not expected to pick up.

We have made a clear prioritization of where we want to grow and have narrowed our focus on the engineering sector where we can also leverage our inherent strengths. We hope to remain actively invested in the cause of an educated Pakistan and strive to ensure that there is no negative impact of our operations on the communities where we operate.

For me it is important that Crescent Steel is a great Company to work for and to own. I am pleased we have been able to demonstrate that we can ride out difficult times and take on challenges. I know that Crescent Steel is a strong Company – one that can absorb shocks and deliver in difficult times, from a long-term viewpoint.

LOOKING AHEAD

NATIONAL ECONOMY

Pakistan is located at the crossroads of regional markets with a diverse and young population, huge resources and untapped potential for trade. Given its location, size and population, Pakistan has strategic geopolitical advantage and development potential. Pakistan is also the launchpad for China's One Belt One Road Project; an ambitious road and sea trade route spanning 65 countries. All these factors make Pakistan attractive for investment.

The country, however, faces significant economic, governance and security challenges to achieve durable development outcomes. The lack of reliable energy and water infrastructure, a largely uneducated and unskilled workforce, ongoing conflict in the border areas and security challenges throughout the country affect all aspects of life in Pakistan and impedes development and economic growth.

On the back of increasing inflationary pressures, devaluation of the rupee and capital flight, Pakistan's economic conditions further deteriorated during FY19. The pace of economic growth slowed down considerably during FY19 to 3.3% and is projected at 2.5% for FY20 [FY18: 5.8%]. This was mainly in response to policy induced demand containment measures. These contractionary measures: monetary tightening (rates up 500 bps since January 2018), currency depreciation (PKR devalued c.32% during FY19) and imposition of regulatory measures alongside a substantial cut in the PSDP outlay affected the performance of the industrial sector and dampened manufacturing activities in the country. Large Scale Manufacturing posted a broad-based 2.9% decline during the first nine months of FY19, compared to a 6.3% growth recorded during the same period last year; nearly all the leading sectors contracted during the review period.

Inflation, clocking in at 5.8% for FY18 and averaging at 6.8% in the first 9 months of FY19, rose sharply and stood at 10.3% for the fiscal year.

Towards the end of FY19, the challenges faced by the economy continued to persist.

Going forward, it is imperative that the government works to provide affordable infrastructure, competitive markets, skill development and business facilitation. The private sector, on the other hand, has to focus on adoption of innovation and technology to improve product and market diversification.

With stabilization policies in place and the economy moving along the reforms agenda, the country's macroeconomic indicators are expected to slowly revert to a stable trajectory. In this process, however, demand and growth is likely to remain contained. Related to this, the revenue measures announced in FY20 Federal Budget are likely to keep disposable incomes and domestic demand under check.

Amid such conditions, industrial growth is not expected to rebound notably next year. Corporate sector earnings and growth will take a hit as input costs rise exacerbated by regulations, devaluation results in lower capex and reinvestment restricting growth, and contained demand hurting turnover.

OUR BUSINESS

Crescent Steel's flagship operations are line pipe manufacturing and coatings. Large diameter line pipes are used in hydrocarbons transportation in the energy cycle. Pipes must transport oil and gas safely across rivers and mountains, through towns and villages, as communities and the environment rely on their long-term integrity to ensure their well-being. In addition to energy transmission, pipes are also used for transportation of water and as piles in the construction industry. As we narrowed focus on engineering as the engine for growth, for Crescent Steel and for Pakistan, we set out to add steel long products to our portfolio; these operations form our core business lines. However, we understand that we need to continue to innovate to remain relevant and ensure we can augment capacity in our growth areas.

We operate in a dynamic and competitive environment where new investment in the region is catapulting us into a world of rapid growth, change and competition; likely to force innovation. We see great opportunity to embrace this growth. We understand that our business is tightly linked with development; as with all development, it goes through cycles of feast and famine as development is deeply rooted to society and so demand in this segment fluctuates significantly. To buffer the periods of famine, we have built a strong corporate structure including ancillary revenue wallets and cash flow buffers.

Our business successes mean a durable and sustainable energy and water infrastructure for Pakistan and sustainable indigenous sources of steel raw material. This is highly dependent on the pace of infrastructure development (specifically in the energy and water transportation and construction segments) and easy access to capital at reasonable costs.

Our key customers in the line pipe segment are state owned utilities that are monopolies and where business is awarded through tenders. Delays in tenders or changes to government's strategic direction causes projects to be delayed or stalled altogether. On the operational front, at times, when the projects do come through tender conditions, specifically with respect to deliveries makes it difficult to compete with giant mills in China where there is both an FTA and a duty advantage to exporters. Additionally, uncertainty in duty structures restricts our ability to protect margins. Looking ahead there are many projects in pipeline that are important for sustained energy and water security; we have conviction that these projects will materialize in the medium term. In addition to energy infrastructure augmentation projects, water sector projects like the Karachi Bulk Water Supply (K4), Islamabad Water Supply Project and the Thar Coal Power Project are also in the pipeline. Additionally, we do expect some demand for piles to be generated as port and jetty related activities kick off on the back of increased trade flows.

For our steel long products business, we expect market dynamics and liquidity constraints to ease, allowing us to resume operations by mid Q2 FY20 as the sugar crushing season commences. We anticipate demand in the construction sector to remain lackluster during fiscal year 2020 but expect it to gradually pick up pace. A key driver for demand for billets will be generated by the government housing scheme, should that materialize during the year.

Constrained by its size, the cotton division is not expected to outperform, however, the unit will support our topline during this period of contained demand for other businesses. Our portfolio management business is also not expected to outperform in 2020 as the general state of the economy will dampen corporate sector earnings and payouts. This is likely to settle towards the end of fiscal year 2020.

Strategically we plan to shed some of the fat and harness gains on ancillary assets like real estate to finance any working capital or required capital investments – this will also enable us to avoid debt at prevailing high costs.

The federal budget for FY20 targets an aggregate outlay of Rs. 8,238 billion and has allocated Rs. 701 billion towards the Public Sector Development Program. We do not expect the government to move ahead with any planned projects that require additional pipelines in the immediate short term, however, the 1,100 km Karachi-Lahore pipeline is still on the cards and may trigger demand for line pipes and coating applications.

We have a clear strategy and our focus for the year ahead remains of strengthening our position in the engineering sector and on reviewing our existing asset base to get leaner and more agile as we continue to build pathways towards future sustainable and long term gains and growth.

In concluding we maintain a cautious outlook on country performance and given current indicators expect growth and demand to remain constrained in the short term. We also expect the government to remain conservative on spending and do not therefore expect development projects to be initiated over the next fiscal year.

This financial year has been challenging and we are geared for yet another year of challenges and shocks – I am pleased that we put in place the building blocks to ensure we emerged from these challenges a stronger and more focused business, able to respond to the changing dynamics of the markets we operate in.

Finally, I would like to recognize and thank our key stakeholders – our customers, our suppliers, the communities in which we operate, our business partners and particularly you, our shareholders for your ongoing support. I would also like to thank the Board and its committees for their proactive role in guiding us, and to all our employees and my management team for their strong commitment and their outstanding contribution in a very challenging time.

I look forward to your continued support in our collective journey to build a sustainable and value creating enterprise.

Ahsan M. Saleem
Chief Executive Officer

2 September 2019