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 2020.

DEAR INVESTORS, CUSTOMERS, PARTNERS, AND EMPLOYEES:

The financial year under review has been an extremely challenging one, compounding the effects of difficulties faced due to a policy induced slowdown that has continued for the most part; businesses operated by us across sectors faced severe pressures due to the uncertain conditions and a complete halt in activity seen in response to the COVID-19 pandemic during the latter half of the fiscal year while the first half was marred with a slowdown in demand across industries, specifically steel and engineering, as well as staggering input costs.

The Government responded to the pandemic induced crisis with stimulus spending of hundreds of billions to mitigate the damages from ensuing lockdowns and supply chain disruptions. Measures included slashing the policy rate by 625 basis points to 7% over a period of 3 months, as well as various debt schemes to cushion cash flow pressures on businesses and to minimize potential unemployment. The Government announced a PKR 1.2 trillion package, to support the textile and construction sectors, along with PKR 75 billion relief package for labour.

Crescent Steel closed the year with a loss after tax of Rs. 17 million (FY19: Profit after tax of Rs. 143 million) and a contribution to the exchequer and economy aggregating Rs. 1,793 million. On a consolidated basis, the Group posted a loss of Rs. 20 million (FY 19: Rs. 419 million). Consequently, Crescent Steel did not pay out any dividend this year.

The Company posted sales of Rs. 3,822 million (FY19: Rs. 4,067 million), down 6.0% YoY on account of idling due to a steep fall in demand. Gross profit margins fell to 1.3% (FY19: 5.4%), operating profit margin also fell, however was protected by investment income of Rs. 389 million (FY19: Rs. 192 million), constituting primarily of dividend income from strategic investments.

Our trading portfolio recorded a negative ROI of 0.50% on weighted average investments of Rs. 134 million, the benchmark KSE-100 index decreased by 1.54%. Dividend income from strategic investments enabled an ROI of 15.9% on the entire portfolio.

EBIT decreased to Rs. 191 million (FY19: Rs. 269 million), representing a margin on net sales of 5.0% (FY19: 6.6%) while underlying EBITDA totaled Rs. 417 million (FY19: Rs. 385 million) at a margin of 10.9%. RoCE declined to 2.3% (FY19: 3.6%).

Consequently, Loss per share (LPS) for FY20 stood at Rs. 0.22 as against EPS of Rs. 1.85 in FY19 and LPS of Rs. 0.26 and Rs. 5.40 on a consolidated basis in FY20 and FY19, respectively.

The Group bottom line before consolidation adjustments stood at Rs. 4 million (FY19: negative Rs. 225 million), profits from investments were entirely eroded by losses from Steel Division. Accounting standards require exclusion of dividend income and inclusion of share of profit from associates resulting in a bottom-line loss of Rs. 20 million after consolidation adjustments. On a group basis underlying EBIT increased 68.2% to negative Rs. 141 million (FY19: Negative Rs. 444 million) representing a loss on net sales of 3.7%. EBITDA totaled Rs. 369 million representing a margin of 9.7%. This translated into a loss per share of Rs. 0.26 (FY19 LPS: Rs. 5.40). Segment wise performance is covered separately in this report for business units and subsidiaries.

In addition to record low revenues and idling costs, the bottom-line impacts include exchange losses of PKR 25 million, an income reversal against ijara financing (lease) that had been deferred to 2021 of Rs. 20 million and a net charge of Rs. 34 million in respect of retirement benefit funds as compared to income of Rs. 5 million recorded in FY19.

Our balance remains strong at Rs. 9,661 million (FY19: Rs. 8,287 million) and continues to support our business through a difficult operating environment. This had particularly been helpful in the amalgamation of underperforming units Hadeed and CS Energy and in managing periods of famine faced our core business line. Despite turbulent conditions, the Company book value has grown at a compounded annual growth rate of 7.2% since 1987 from Rs. 7.11 to Rs. 70.2 as on 30 June 2020. The share price as on June 30th stood at Rs. 45.5 per share.

To buffer liquidity impacts of the pandemic induced crisis, we availed the Central Bank led facility to finance wages to the tune of Rs. 51 million at concessional rates and were able to defer long term loans of Rs. 195 million by a period of 12 months. This significantly eased up cash flow pressures during these uncertain times.

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

In addition to rapidly deteriorating economic indicators, falling demand, a falling Rupee and rising input costs, businesses across the globe saw massive disruptions to supply chains and operations in the face of the COVID-19 pandemic that saw entire economies come to a complete halt.

For us performance depends heavily on the progress of energy and water infrastructure development projects and, on domestic growth. Falling demand, the mismatch between revenues and deficits, Rupee depreciation and COVID-19 related shutdowns caused operating and supply chain costs to go up, hurting business. As a result, all our operations were negatively affected by worsening conditions.

In this environment the immediate need was to contain the damages and move to business as usual operations as soon as possible. I am happy to share that our IT infrastructure was robust and ready to quickly enable work from home arrangements and most of our people were on remote working protocols on an immediate basis. As a result, we managed to operate, often with very thin staff and successfully deployed business continuity and incident management plans to cope with this crisis. Nevertheless, these were unprecedented conditions and as with most businesses, we faced a temporary shutdown of our manufacturing facilities during the last quarter of the fiscal year.

Energy infrastructure development projects that use pipes have 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 7,675 tons of steel line pipe during the year as against 12,068 tons in FY19.

Steel Division revenue stood at Rs. 1,291 million (FY19: Rs. 2,381 million) and generated gross profit of Rs. 34 million i.e. 2.6% (FY19: GP of Rs. 115 million i.e. 4.8%) due to low order intakes and its consequent idling cost during 1HYFY20. Bottom line loss before tax for the year was Rs. 392.2 million (FY19: LBT Rs. 197.8 million).

The Cotton Division too continued to face challenges, with respect to competing at this scale of operations, faced with rising input costs, tariff anomalies with regional competitors and lockdown of almost two months due to COVID-19. The unit produced 7,190,635 Kgs (on basis of 20/1 count). The division posted sales of Rs. 1,346 against Rs. 1,685 million in FY19 at a gross margin of 1.9% amounted to Rs. 26 million (FY19: 106 million i.e. 6.3%) whereas, loss before tax of Rs. 27 million (FY19 PBT: Rs. 70 million).

Our capital markets segment provided working capital and cash flow support to our core business. The KSE 100 index fell by 37.78% from 43,000 points on 14 January 2020 to a low of 27,046 points on 26 March 2020, albeit recovering by 7,375 points to close at 34,422 points, on 30 June 2020. The local bourse, however, remained under pressure due to the pandemic induced crisis, foreign selling of USD 205 million, liquidity pressures, uncertain and weak macro-economic fundamentals and weaker corporate sector performance. The division posted a PBT of Rs. 363 million which includes dividend income of Rs. 353 million, realized loss of Rs. 4 million and unrealized gains of Rs. 38 million. Of this, Rs. 343 million constitutes dividend from strategic investments. The steel long products business posted a loss before tax of Rs. 35 million and performance of the power plant also in the red zone with a loss before tax of Rs. 27 million. 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 12.8% 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.

2020 has been an exceptionally challenging year for Crescent Steel, especially when looked at alongside the challenges to business in 2019. I am extremely proud of my team for riding out these tough times with the Company where the senior management has taken no raise in pay for a second year in a row, steering their teams and all our people who have demonstrated entrepreneurship in the way they work – working tirelessly to manage the crisis from raising working capital to meet fixed costs to seeking alternate streams of revenues.

We expect market conditions to remain challenging and for demand to remain sluggish over the next fiscal year, before things begin to improve. We are already seeing some recovery in sentiment in the performance of capital markets, but we do not expect much progress in public sector development projects in the short term and so demand for line pipes is not expected to pick up. Operations in our billet manufacturing unit, on the back of improving conditions in the construction segment, especially the government's housing scheme may see improvements in the short term.

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 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.

I am pleased that 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

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

Inflationary pressures and devaluation continue to strain the manufacturing segment, in general. Coupled with these issues, a steep cut in PSDP is a threat to industries like us who are directly affected by lower spending on infrastructure projects.

Stepping into FY21, economic activity should be gaining some momentum, aided primarily by government stimulus spending to mitigate the pandemic induced crisis. A major blessing in disguise from the pandemic induced crisis has been the reduction in policy rates, substantially easing the cost of funds for business, making it easier to operate.

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, the real GDP growth is likely to remain contained. In particular, adjustment on the fiscal side has yet to get underway. Related to this, the revenue measures announced in FY21 Federal Budget are likely to keep disposable incomes and domestic demand under check. Amid such conditions, the industrial growth is not expected to rebound notably next year.

Low interest rates enabled improved liquidity as investors shifted from high yielding fixed income investments to a largely discounted stock market and were more willing to take on CAPEX which is important for growth. During the month of July 2020, the market gained 4,836.44 points or 12.32% percent to close at 39,258.44 points. The KSE-100 is currently trading at a forward PE of 7.3x times and an average dividend yield of 6%.

Multiple projects triggering demand for line pipes are on the cards however, none are likely to materialize in the short term. There is some momentum in the Oil and Gas segment, specifically with regards to pipeline capacity augmentation to transport import LNG that may partially come through in the coming year. Additionally, the Supreme Court decision mandating GIDC collections be spent on gas infrastructure development may trigger demand for line pipes. Other than planned Oil and Gas sector projects, we expect some serious initiative for Karachi Bulk Water Supply project for Karachi and some demand for pipes in the construction segment.

We expect to see improving demand and pricing equilibrium for rebars and billets on the back of the relief package announced for construction industries as well as ongoing CPEC projects. Consequently, we are expecting better performance on sales and profit margins from our steel melt-shop.

Given these conditions, 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. It is unlikely that the local bourse will post any substantial gains during FY21 and is likely to remain range bound.

We have faced some extraordinary challenges across our business segments; however, as a Group we stayed true to our mission and guiding principles. 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 and world we operate in. It has put into perspective the importance of flexibility and resilience in the face of unprecedented events and Acts of God.

I would 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.

Finally, I would like to recognize and thank our other key stakeholders – our customers, the communities in which we operate, our business partners and particularly you, our shareholders for your ongoing support.

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

28 August 2020