CEO'S REVIEW

DEAR INVESTORS:

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 2021.

In a year characterized by extraordinary global and financial challenges, I am proud of what we were able to accomplish. Crescent Steel's foundational strength and the agility of our operating model, in addition to the unparalleled commitment of a resilient workforce, allowed us to finish the year with a solid performance and make progress across important strategic objectives, setting the stage for future growth.

Economic performance was able to recover, although not to pre-pandemic levels, primarily on the back of a favorable policy induced operating environment that saw low interest rates, a managed current account and a pick-up in inoculations, trigger domestic demand and alleviate concerns, specifically, pandemic related uncertainty. Strong recovery is indicative in healthy corporate sector results as well as the 8% growth in Large-Scale Manufacturing (LSM), leading to an overall growth of 3.9%.

The flexibility and strength of our operating model, and the efforts of our leadership and teams, allowed us to end the year with stronger results, in line with our objectives to protect our financial position and maintain buffers to market shocks.

Crescent Steel closed the year with a profit after tax of Rs. 352 million (FY20: Loss after tax of Rs. 17 million) and a contribution to the exchequer and economy aggregating Rs. 2,213 million (FY20: Rs. 1,793 million). On a consolidated basis, the Group posted profit after tax of Rs. 791 million (FY 20: Loss after tax of Rs. 20 million).

Revenues were up 89.9% from last year at Rs. 7,259 million driven primarily by a pick-up in demand in the steel pipe and billet segments both of which saw sales growth of **112.4%** over last year to Rs. 4,805 million in FY21 (FY20: Rs. 2,262 million) – mostly organic growth with volumes for steel line pipe and billet sales almost doubling. Gross profit margins increased to **6.8%** (FY20: 1.3%) and operating profit margins also improved to **8.7%** (FY20: 5.0%).

The Company's investment division, which is strategically positioned to meet capital related needs and buffer periods of slow demand, posted an accumulated profit before tax (PBT) of Rs. 341 million (FY20: Rs. 363 million). Our trading portfolio recorded an ROI of 36.5% on weighted average investments of Rs. 153 million whereas the benchmark KSE-100 index increased by 37.6%. On a consolidated basis (including CS Capital Private Limited), the investment division posted a PBT of Rs. 839 million, of which Rs. 195 million constitutes unrealized gains on account of revaluation of unquoted strategic investments and Rs. 383 million in share of profit from associates. The PBT also includes gains on disposal of investment property of Rs. 128 million.

EBIT increased to **Rs. 637** million (FY20: Rs. 191 million), representing a margin on net sales of 8.8% (FY20: 5.0%) while underlying EBITDA totaled **Rs. 855** million (FY20: Rs. 417 million) at a margin of 11.8% (FY20: 10.9%). ROCE increased to **15.6%** (FY20: 2.3%).

The Group bottom line on a consolidated basis stood at **Rs. 791** million (FY20: negative Rs. 20 million). On a consolidated basis underlying EBIT increased to Rs. 756 million (FY20: Negative Rs. 141 million) representing a margin on net sales of 10.4%. EBITDA totaled Rs. 1,359 million representing a margin of 18.7%.

Consequently, Earnings per share (EPS) for FY21 stood at **Rs. 4.53** as against Loss per share (LPS) of Rs. 0.22 in FY20 and, an EPS of Rs. 10.19 on a consolidated basis in FY21 (FY20: LPS of Rs. 0.26). Segment wise performance is covered separately in this report for business units and subsidiaries.

Crescent Steel did not distribute profits this year for two reasons – Rs. 201 million came from unrealized gains on investments and, we foresee higher cashflow requirements in the business cycle on account of a global increase in commodity prices and a general uptick in input costs.

Our balance sheet remains strong at Rs. 8,706 million (FY20: Rs. 9,661 million) and continues to support our business through all difficult operating environment periods 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 7.0% since 1987 from Rs. 7.11 to Rs. 76.91 as on 30 June 2021. The share price as on 30 June 2021 stood at Rs. Rs 83.98 per share.

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

FY21, although marred by uncertainty as COVID-19 reached pandemic levels, saw the beginnings of global recovery. Markets began to reopen, supply chain disruptions eased out and accommodative government policies helped trigger demand. This is indicated in the sales growth we spoke of earlier as well as sustained investment income from investments in Pakistan corporates.

Energy infrastructure development projects that use pipes have been the single most important contributor to growth and hiring for us in the past and are material to business sustainability for us today. We produced and supplied 15,400 tons of steel line pipe during the year as against 7,675 tons in FY20 and 12,068 tons in FY19. Line pipe coatings, however, saw a decline with 22,587 sq meters of line pipe coatings in FY21 as against 88,647 sq meters in FY20 and 340,745 sq meters in FY19.

Revenues from steel line pipe and line pipe coatings stood at **Rs. 2,740** million (FY20: Rs. 1,291 million) generating gross profits of Rs. 420 million i.e. 15.3% (FY20: GP of Rs. 34 million i.e. 2.6%). PBT for the year was Rs. 85 million [FY20: Loss before tax (LBT) of Rs. 392 million] at a 20% contribution to total PBT.

Local cotton prices peaked to a 10-year high on account of a sharp drop of 38% in the cotton arrivals for ginning. However, market rates for yarn remained strong during the year, yielding good margins due to increased demand of exports. The plant remained operational at full capacity and produced 8.79 million Kgs (converted on 20/1 count). The division posted sales of **Rs. 2,000** million at a gross margin of Rs. 211 million i.e. 10.6%, against Rs. 1,346 million in FY20 (Gross Margin: 26 million i.e. 1.9%) and Rs. 1,685 million in FY19 (Gross margin: Rs. 106 million or 6.3%). The unit posted a PBT of Rs. 171 million, a contribution of 40.1% to total PBT (FY20: LBT of Rs. 27 million).

Our capital markets segment continued to provide working capital and cash flow support to our core business, generating Rs. 115 million in free cash flows and supporting capital needs of the business through the disposal of investment property and pledge of assets for funded and non-funded limits aggregating Rs. 1,665 million. FY21 saw the local bourse peaking at 48,982 points on 14 June 2021, almost 42% up from its close on 30 June 2020 at 34,422 points. The KSE-100 closed FY21 at 47,356 points up 37.6% – this was the highest annual return since FY14. Corporate sector earnings saw a sharp improvement as results were announced throughout the year and trading at an almost 60% discount the local bourse offers attractive future yields.

Production at the steel billet unit doubled to **20,950** tons in FY21 as against 10,894 tons in FY20 and 29,162 tons in FY19. The unit posted a gross loss of Rs. 139 million (FY20: Gross profit of Rs. 11 million) and LBT of Rs. 172 million (FY20: LBT of Rs. 35 million). We continued to face a host of operational challenges at Hadeed throughout the year, the most pronounced of these being power constraints. During the year our teams worked hard to get the unit on the national grid, however, a connection was not sanctioned despite surplus power being available in the system. Consequently, the unit operated at a capacity utilization of 24.6% making it difficult to absorb fixed costs while changing market dynamics also eroded profitability.

The bagasse fired thermal plant, produced and supplied **13,971** MWH of own source energy to the billet manufacturing unit at Rs. 9.0 per Kw/h (FY20: 7,360 MWH at Rs. 9.0 per Kw/h), representing a delta on market-based energy costs of Rs. 9 per Kw/h, and closed the year at breakeven levels with a PBT of Rs. 1 million (FY20: LBT of Rs. 27 million).

2021 has been a challenging year for Crescent Steel. I am extremely proud of my team for riding out these tough times, 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 revenue, managing cost base and more.

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

FY22 will see benefits of increased development spending, reduced/rationalized tariff structures on the import of raw materials and capital goods take effect – largely supportive monetary and fiscal conditions will support growth which is being forecasted at 4.2% for FY22.

International commodity prices, including that of steel have skyrocketed this year, coupled with the rise in crude prices and supply chain disruptions (trade flows) these have directly contributed to an escalation of freight costs, which are likely to persist in the medium term and may never revert to pre-covid levels. Input costs, therefore, are likely to remain high. This will also directly affect prospects of exports from Pakistan as it is not generally a port of call for vessels.

Market conditions are likely to remain challenging as socio-political dynamics in the region shift post US exit from Afghanistan presenting varying degrees of security and economic challenges for Pakistan.

Demand will gradually pick up although, containment measures will follow as inflationary, and balance of payments pressures build up. Corporate sector earnings announced during the year have been promising and indicate a stronger than expected recovery in industry and services sectors, however, capital markets performance will depend heavily on stability in liquidity, political and socio-economic conditions. We expect it to remain range bound and post stable returns based on historical Compound Annual Growth Rate (CAGR).

We do not expect a significant rise in demand for steel line pipes in the short term but as time passes energy import infrastructure and upcountry supply lines are becoming increasingly critical and will trigger line pipe demand in the medium term. We have seen some momentum in the Oil and Gas segment, specifically with regards to pipeline capacity augmentation to transport imported LNG; these may continue to come through in smaller lots during FY22. The North South project, however, seems to be facing planning challenges even though it is an imperative for national energy security. Other than planned energy sector pipelines, we expect follow through on the Karachi Bulk Water Supply project as well as some demand for pipes in the construction segment, as we continue to push for market development in this area. Similarly, we will continue to develop the market for line pipe coatings and encourage end users of pipes to move from traditional coating applications towards best practice in anti-corrosion and protective coatings.

Operations in our billet manufacturing unit, on the back of improving conditions in the construction segment, especially the government's housing scheme as well as some anticipated amendments to duty structures, may see improvements in the short term. Demand and pricing for rebars and billets are in equilibrium on the back of the relief packages for construction and housing schemes. Consequently, we are expecting better performance on sales and profit margins from our steel melt-shop. Having said that this is heavily dependent on reliable power, without which capacity utilization at the unit for FY22 will remain low. Our teams, however, are working hard to get the unit on the national grid and push beyond budgeted production targets to absorb fixed costs.

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.

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 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

12 August 2021