CEO'S REVIEW

DEAR FELLOW SHAREHOLDERS:

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 2022.

Despite being one of the most challenging periods, on an overall basis your Company did well from a cash flow perspective, closing the fiscal year at an EPS of 4.72. Crescent Steel however, did not distribute profits this year. This is primarily because import policy induced requirements for significantly higher free cash-flows as we are required to place 100% cash margins against HRC raw material and other imports for the projected bid book and orders for energy and water infrastructure projects.

The outgoing fiscal year has been one of the most turbulent years for global economies as stimulus packages from the pandemic crisis caught up and we saw global economies overheating to unsustainable levels triggering monetary tightening amidst peaking global commodity prices and the Russia-Ukraine conflict which only compounded economic challenges by triggering supply chain and food and energy market disruptions globally.

The flexibility and strength of our operating model, and the efforts of our leadership and teams, enabled us to end the year with positive results despite continued idling at our core manufacturing facilities.

Crescent Steel closed the year with a profit after tax of Rs. 367 million (FY21: Rs. 352 million) and a contribution to the exchequer and economy aggregating Rs. 2,467 million (FY21: Rs. 2,213 million). On a consolidated basis, however, the Group posted loss after tax of Rs. 647 million (FY 21: Profit after tax of Rs. 791 million).

The Company's investment division, which is strategically positioned to meet capital related needs and buffer periods of slow demand in our core business, posted an accumulated profit before tax (PBT) of Rs. 950 million (FY21: Rs. 341 million). The PBT includes dividend income of Rs. 1,158 million of which PKR 1,122 million is strategic investments. Our trading portfolio recorded a negative ROI of 12.9% on weighted average investments of Rs. 267 million while the benchmark KSE-100 index decreased by 12.3%.

The Company posted sales of Rs. 7,090 million (FY21: Rs. 7,259 million), down 2.3% YoY. Gross profit margins fell to negative 0.9% (F21: 6.8%).This is primarily due to a steep increase in input raw material prices especially steel raw material, eroding profitability. Operating profit margins stood at Rs. 450 million or 6.3%, protected by investment income.

EBIT of Rs. 561 million (FY21: Rs. 637 million), represents a margin on net sales of 7.9% (FY21: 8.8%) while underlying EBITDA totaled Rs. 769 million (FY21: Rs. 855 million) at a margin of 10.8% (FY21: 11.8%). RoCE increased marginally to 4.9% (FY21: 4.3%).

Consequently, Earnings per share (EPS) for FY22 stood at Rs. 4.72 as against EPS of Rs. 4.53 in FY21 and, loss per share of Rs. 8.34 on a consolidated basis in FY22 (FY21: EPS of Rs. 10.19).

Segment wise performance is covered separately in this report for both business units and subsidiaries.

The Group bottom line on a consolidated basis stood at negative Rs. 647 million (FY21: Profit after tax of Rs. 791 million) mainly because of equity accounting for dividend income of Rs. 1,183 million received from strategic investments. As a result, while dividend income was booked in stand-alone financial statements, on a consolidated basis Rs. 86 million was recorded as share of profit from equity accounted investment. On a consolidated basis underlying loss before interest and tax amounted to Rs. 621 million (FY21: EBIT of Rs. 756 million) representing a negative margin on net sales of 8.8% and reflects the challenges faced by the businesses we operate.

We draw comfort from a strong balance sheet footing of Rs. 8,445 million (FY21: Rs. 8,706 million) which continues to support our business through a difficult operating environment and in managing periods of famine faced our core business line which primarily serves line pipe requirements of national energy and water infrastructure projects. Despite extremely volatile conditions especially over the last few years, the Company book value has grown at a compounded rate of 10x since 1987 from Rs. 7.11 to Rs. 78.55 (adjusted for gains on strategic investments held at cost the indicative break-up value is Rs. 88.48 per share) as on 30 June 2022. The share price as on 30 June stood at Rs. 41.67 per share.

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

Energy infrastructure development projects that use pipes have been the single most important contributor to growth and hiring for us in the past and remain material to business sustainability for us today.

The nature of the product is such that it is closely linked to infrastructure development and over the last few years we have seen a cut in the deployment of infrastructure spend, in part owing to rising fiscal deficits as well as extremely uncertain political conditions. We produced and supplied 5,082 tons of steel line pipe during the year against 15,400 tons in FY21 and an installed notional capacity of 200,000 tons. Line pipe coatings, saw an increase with 96,667 sq. meters of line pipe coatings in FY22 as against 23,138 sq. meters in FY21. Revenues from the steel division stood at Rs. 1,392 million (FY21: Rs. 2,740 million) generating gross loss of Rs. 134 million i.e. 9.7% (FY21: GP of Rs. 420 million i.e. 15.3%). Profitability on the already weak order book was eroded entirely due to a steep rise in raw material prices between the bid and award period. Consequently, the division posted a loss before tax (LBT) for the year was Rs. 550 million [FY21: PBT of Rs. 85 million] on account of plant idling of approximately 266 days resulted in unabsorbed fixed cost.

International cotton prices peaked to a 10-year high during the outgoing fiscal year and market rates for yarn, remained strong as well, yielding sustained margins. The plant remained operational at full capacity and produced 8.5 million Kgs (converted to 20/1 count). The division posted sales of Rs. 2,695 million at a gross margin of Rs. 276 million i.e. 10.3%, against Rs. 2,000 million in FY21 (Gross Margin: Rs. 211 million i.e. 10.6%). The unit posted a PBT of Rs. 199 million (FY21: Rs. 171 million).

Our capital markets segment continued to provide working capital and cash flow support to our core business, generating Rs. 946 million in cash flows and supporting capital needs of the business through pledge of assets for funded and non-funded limits aggregating Rs. 992 million. FY22 saw the local bourse losing 5,815 points or 12.3% to close at 41,540 points on 30 June 2022. In USD terms the market lost 35.5% during the outgoing fiscal year. This was driven by growing economic and political uncertainty, rising interest rates, rupee devaluation. During the year foreign selling stood at USD 279.5 million and volumes remained dull averaging 292 million shares/day. Political uncertainty, rising interest rates/money market yields, and weak macro-economic fundamentals in addition to low FIPI participations and expectations of weaker corporate sector performance continue to add pressure on KSE-100 performance. The division posted a PBT of Rs. 950 million which includes dividend income of Rs. 1,158 million, realized loss of Rs. 2 million and unrealized loss of Rs. 187 million. The KSE-100 index is currently trading at a historic low PE of 4.25 times and a forward PE of 3.87 times compared to the regional average of 16.48 times and a 15-year historical PE of 8 times and is well positioned to post a strong recovery at any sign of improvement on economic and political fronts.

The steel long products unit manufactured 17,707 tons in FY22 as against 20,950 tons in FY21 and 10,894 tons in FY21. The unit posted a gross loss of Rs. 164 million (FY21: Rs. 139 million) and LBT of Rs. 235 million (FY21: Rs. 172 million). We continued to face a host of operational challenges at the unit throughout the year, the most pronounced of these being power constraints. Consequently, the unit operated at a capacity utilization of 20.8% making it difficult to absorb fixed costs while changing market dynamics, in particular rising raw material prices, also eroded profitability. To address the power constraints at the unit and remove dependency from captive power we worked to secure a grid connection during the outgoing fiscal year – this is now in advanced stages and commissioning should be completed by H2FY23.

The bagasse fired thermal plant, generated and supplied 24,158 MWH of power and 187,422 tons of steam. Of this, 9,205 MWH of own source energy was supplied to the billet manufacturing unit. The plant enables us to capture a meaningful delta on power related costs that would otherwise need to be sourced from the national grid. The division closed the year at a LBT of Rs. 49 million (FY21: PBT of Rs. 1 million) primarily due to idling on account of a late start to the sugar season which disrupted supply of bagasse.

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 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's economy exhibits an episodic pattern of growth characterized by boom-and-bust periods. A narrow production and export base makes the economy less resilient to adverse economic shocks, which results in a binding balance-of-payment constraint to growth. A large fiscal deficit, a weak external position, and eroded macroeconomic buffers reflect structural weaknesses. The limited fiscal space holds Pakistan back from tackling infrastructure and social sector deficits, critical to building resilience.

The high cost of doing business for the private sector restricts international competitiveness. Governance bottlenecks and institutional capacity challenges continue to persist. Consequently, low levels of human capital development result in low labor productivity. A combination of strained growth, inadequate human capital and social protection, and the underexploited potential of the able to work population exacerbates poverty pressures and intensifies income inequality. On top of this, a stressed water situation, environmental degradation, natural disasters, and climate change-associated risks threaten sustainability. In this backdrop the country seems to be stuck in one political crisis after another – making meaningful reforms even more difficult to achieve.

In the wake of yet another economic meltdown – soaring twin deficits and a looming balance of payment crisis and an active political crisis ultimately leading to a change in government just before the FY23 budget – measures to keep growth in check had to be introduced. Policy rates were increased by 675bps during the year to 15% and the rupee rerated against the greenback losing 30.03% to close the fiscal year at Rs. 204.84 per USD. The weakening rupee, coupled with an increase in commodity prices across the board intensified pressure on the country's depleting foreign reserves and domestic inflation which soared to 24.9% in July and stood at 12.15% for FY22. Restrictive import regulations especially 100% cash margin requirements were introduced.

The Greater Karachi Bulk Water Supply project K-IV has been awarded to an international contractor with whom we are in advanced stages of negotiating pipe conversion and line pipe coating business for part of the project. The project is expected to commence during H2FY23 and would span 12 months. We have also seen some line pipe demand in the Oil and Gas segment, specifically with regards to pipeline capacity augmentation projects; these are also in the final stages of bid evaluation. Our bid book in this segment is reasonably healthy–should these materialize in our favour the work would span H2FY23-Q1FY24.

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.

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

24 August 2022