RATING REPORT

Crescent Steel & Allied Products

REPORT DATE:
May 29, 2018

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@jcrvis.com.pk

Asfia Aziz
asfia.aziz@jcrvis.com.pk

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A+/A-2**	**A+/A-2**
Rating Date	*May 29, 2018*	*July 3, 2017*
Rating Outlook	*Negative*	Stable
Outlook Date	*May 29, 2018*	*July 3, 2017*
Commercial Paper	A-2	A-2

COMPANY INFORMATION	
Incorporated in 1983	**External auditors:** KPMG Taseer Hadi & Co.
Public Limited Company	**Chairman of the Board:** Mr. Ahmad Waqar
Key Shareholders: - The Crescent Textile Mills Limited – 11% - Jubilee Life Insurance Limited- 9.58% - Islamic Development Bank – 6.11% - Bilquis Saleem – 5.48% - EFU Life Assurance Limited- 5.32%	**Chief Executive Officer:** Mr. Ahsan M. Saleem

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016) ***http://www.jcrvis.com.pk/kc-meth.aspx***

Crescent Steel & Allied Products Limited (CSAPL)

OVERVIEW OF THE INSTITUTION

CSAPL was incorporated on August 1, 1983 as a public limited company listed on the Pakistan Stock Exchange (PSX). It is mainly engaged in the manufacturing of large diameter spiral welded steel pipes, used mainly for transmission of oil, gas and water resources. The Company operates three divisions- Steel, Cotton, and Investment and Infrastructure Development Division and three wholly owned subsidiaries- Crescent Hadeed (Private) Limited, CS Capital (Private) Limited, and Shakarganj Energy (Private) Limited.

Mr. Ahmad Waqar is the Chairman of CSAPL. He is also currently serving as the principal advisor to Chairman of Pakistan Exploration Ltd. Mr. Waqar has diversified experience across entities in both the Public and Private Sector. With regard to the former during his tenure as a Bureaucrat, he has also served as Secretary Privatization, Secretary Petroleum and Chairman FBR.

The management team is spearheaded by Mr. Ahsan M. Saleem. Mr. Saleem has been the Chief Executive Officer and Managing Director of Crescent Steel & Allied Products Limited since its inception. He has over 34 years of extensive industry experience in managing multiple business operations across variety of sectors such as steel, sugar, power, textile

RATING RATIONALE

Crescent Steel and Allied Products Limited (CSAPL) is a diversified business concern with exposure to steel, textiles, capital markets and power sectors. Investment in subsidiaries and associates represent around one-third of total assets at end-FY17. Subsidiaries include a power sector concern (Shakarganj Energy (Private) Limited (SEL)), an investment company responsible for managing investment portfolio in shares and real estate etc. (CS Capital (Private) Limited(CSCPL)) and a steel sector concern operating a steel melt shop and billet manufacturing facility (Crescent Hadeed (Private) Limited- CHL). During FY17, CHL doubled its annual melting capacity from 42,000MT to 85,000MT. The management plans to further increase its melting capacity during 2018 and will also set up a rerolling facility to cater to rising demand for rebars. Moreover, higher capacity utilization is also projected for SEL. Apart from CS Capital, other subsidiaries are in their growth phase with limited dividend expected over the rating horizon.

Company's Operations

Steel Division

This division operates two spiral pipe (SP) production lines & a coating line with the company primarily involved in large diameter pipe manufacturing used in fluid and oil & gas transmission. Over the last four years, steel division has contributed around two-third of total revenues (FY14-FY17). However, contribution to revenues of the steel division has remained significantly higher over the last 30 months. The second SP line was commissioned in the previous fiscal year enhancing annual production capacity to 200,000MT (Previous: 90,000MT) based on pipe size of 30" dia x ½" thickness. The pipe plant's utilization level increased to 53% during FY17 (FY16: 33%) producing 105,290MT (FY16: 66,811MT) of bare pipes. Resultantly, the steel division recorded revenues of Rs. 8.9b (FY16: Rs. 7.4b) during FY17, an increase of 21% as compared to the preceding year. Despite growth in sales, gross margins of the company declined to 21% (FY16: 31%) during the outgoing year owing to higher procurement cost of Hot Rolled Coil (HRC). Sales and gross margins of the company were reported at Rs. 6b and 15.3%, respectively during 1HFY18. Given the projected order pipeline, profitability and cash flows are expected to remain constrained till materialization of orders from RLNG 3 pipeline project.

Cotton Division

During FY17, the company diversified into polyester cotton and polyester viscose due to which the segment reported revenue of Rs. 1.3b (FY16: Rs. 34m) during FY17 thereby reducing quantum of losses before tax to Rs. 45m (FY16: Rs. 139m). Given the challenging operating environment, profitability and cash flows of the cotton segment are expected to remain under pressure.

Investment and Infrastructure Development Division

This division manages a portfolio of equity investments and real estate and has supported the overall profitability of the company during FY17 and 1HFY18. During FY17, the portfolio's profit before tax stood at Rs. 316m (FY16: Rs. 83m). Around three-fourth of the profitability emanated from impairment reversal on strategic investments in Shakarganj Limited of Rs. 100m and dividend income from investment in Altern Energy Limited (AEL) of Rs. 140m. During 1HFY18, profit before tax stood at Rs. 435m primarily comprising investment income from AEL. Given the expected addition of efficiency based power plants in the country's generation portfolio and their higher relative positioning in the dispatch order, quantum of dividend income from AEL will be tracked by JCR-VIS.

Sector Dynamics and Business Risk

Cyclicality in sales is a significant risk particularly for large diameter pipe manufacturers, given the reliance on public sector and pipeline augmentation projects of gas utility companies. Major project announced and for which tendering is expected over the next one year include 1100km North-South gas pipeline (RLNG III). As the only major large diameter spiral pipe manufacturer in the country, and engineering. Mr. Saleem is a co-founder and director at The Citizens Foundation and also serves as a member of the Board of Directors of Pakistan Centre for Philanthropy.

the company is well-positioned to capture a chunk of the new orders. Delay in commencement of work on RLNG III pipeline is a significant business risk factor. Another key risk includes increase in HRC prices post bid submission. This is due to bids being made based on current or expected HRC prices at the time of the contract while contact award and procurement of HRC is done with a time lag. While threat of dumping particularly from China remains a significant risk, duties on pipe imports and high transportation cost has facilitated in partly mitigating competition from imports. Local large diameter pipe manufacturers also enjoy the advantage of SRO 827 through which a price preference is provided to them against imports. Moreover, exchange rate risk is mitigated as per contract terms.

Profitability

Top line of the company reported a significant increase of 38% during FY17 at Rs. 10b (FY16: Rs. 7.4b). Regardless of rising revenues, gross margins of the company witnessed sizeable weakening to 18.2% (FY16: 28.9%) during the outgoing year on account of substantial rise in HRC prices. However, profitability of the company was supported by income from investments of Rs. 247m (FY16: Rs. 43m). Resultantly, the company reported profit after tax of Rs. 1b (FY16: Rs. 967m) during FY17. During 1HFY18, profit after tax was reported at Rs. 837.4m. Materialization of order pipeline and income from investments will determine quantum of future profitability.

Funding and Capitalization

Ratings of the company are based on conservative financial policy evident from maintenance of low leverage profile. Equity base of the company stood at Rs. 7.4b at end Dec'2017, which has been consistently growing owing to sizeable profit retention. At end Dec'2017, gearing and leverage stood at 0.37x and 0.50x (FY17: 0.45x and 0.79x), respectively. During ongoing fiscal year, CSAPL issued a commercial paper of Rs. 719.5m for funding working capital requirements.

Liquidity

Funds flow from Operations (FFO) witnessed a decline during FY17. The company has sizeable debt repayments (including commercial paper) over the next 9 months. Cash generated from operations (excluding working capital changes), investment & dividend income and working capital changes (release of retention money payable and reduction in stock and trade debts) will result in sufficient liquidity to cater to upcoming debt payments. Moreover, liquid investments carried on balance sheet also support assessment of company's liquidity profile. However, at end Dec'2017, stock-in-trade and trade debts do not provide sufficient coverage to short term borrowings.

Corporate Governance

Overall corporate governance framework is supported by strong board composition and oversight, a professional management team and focus on transparency and disclosures.

Crescent Steel & Allied Products Limited (CSAPL) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY15**	**FY16**	**FY17**
Fixed Assets	781	823	941
Long term Investments	3,038	3,935	4,204
Stock-in-Trade	453	2,267	2,687
Trade Debts	88	323	664
Cash & Bank Balances	43	63	28
Total Assets	5,393	9,484	12,180
Trade and Other Payables	638	850	2,002
Long Term Debt	388	639	568
Short Term Debt	302	2,084	2,517
Total Debt	689	2,723	3,086
Total Equity	4,051	5,808	6,820
INCOME STATEMENT			
Net Sales	2,102	7,412	10,209
Gross Profit	32	2,143	1,859
Income from Investments	309	43	247
Profit After Tax	106	967	1,012
RATIO ANALYSIS			
Gross Margin (%)	1.5%	28.9%	18.2%
Net Margin	5.1%	13.0%	9.9%
Net Working Capital	423	1,400	2,096
Trade debts/Sales	4%	4%	7%
FFO	(32)	1,751	1,354
FFO to Total Debt (%)	-5%	64%	44%
FFO to Long Term Debt (%)	-8%	274%	238%
Current Ratio (x)	1.4	1.4	1.4
Debt Servicing Coverage Ratio (x)	0.3	5.9	4.5
Gearing (x)	0.17	0.47	0.5
ROAA (%)	2%	13%	9%
ROAE (%)	3%	20%	16%

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Crescent Steel & Allied Products Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
May 29, 2018	A+	A-2	Negative	Maintained
July 03, 2017	A+	A-2	Stable	Initial

RATING TYPE: COMMERCIAL PAPER

Rating Date	Rating	Rating Action
May 29, 2018	A-2	Final
July 03, 2017	A-2	Preliminary

Instrument Structure	Commercial Paper of Rs. 719.5m issued in 1QFY18 in the form of promissory note at a discount to face value. The issue ranks equally with all other unsecured, subordinated indebtedness of the issuer
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, JCR-VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. JCR-VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2018 JCR-VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to JCR-VIS.