RATING REPORT

Crescent Steel & Allied Products

REPORT DATE:
December 26, 2018

RATING ANALYSTS:
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Rating Category	Latest Rating
Sukuk Rating	A+
Rating Date-Sukuk	*December 26, 2018*
Rating Outlook-Sukuk	*Stable*
Entity Rating	A/A-2
Rating Date- Entity	*December 26, 2018*
Rating Outlook-Entity	*Stable*

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- 7.5% - Islamic Development Bank – 6.11% - Bilquis Saleem – 5.48% - EFU Life Assurance Limited- 5.51%	**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

Applicable Rating Criteria: Instrument (June 2016)
http://jcrvis.com.pk/docs/criteria_instrument_16.pdf

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 CS 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 and engineering. Mr. Saleem is a co-founder and director at The Citizens Foundation and also serves as a member

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 two-fifth of total assets at end-FY18. Subsidiaries include a power sector concern (CS Energy (Private) Limited- CSEL), formerly Shakarganj Energy (Private) Limited), 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).

Company's Operations

Steel Division

This division operates two spiral pipe 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). The pipe plant's utilization level declined during FY18 with actual production being lower at 56,145MT (FY17: 107,699MT) of bare pipes. Resultantly, the steel division recorded revenues of Rs. 6.1b (FY17: Rs. 8.9b) during FY18, a decline of 31% as compared to the preceding year. Decline in sales is a function of non-materialization of projected orders due to delay in financial close of RLNG-3 pipeline. With reduction in sales volumes and higher procurement cost of HRC, gross margins during FY18 declined to 13% (FY17: 21%). Gross margins declined further to 6% during 1QFY19 due to high competition in the tendering business. Going forward, order pipeline is projected to improve in the short-term due to materialization of tenders by gas utility companies and expected commencement of K4 project in FY19. Over the medium term, commencement of work of RLNG-3 pipeline is expected to result in strong topline growth. Given the declining steel prices, gross margins are expected to witness a significant increase on orders where the company is the lowest bidder.

Cotton Division

A turnaround was witnessed in the cotton division whereby the segment reported a gross profit during FY18 and 1QFY19. Improvement in margins was a function of higher sales volumes and favorable price dynamics for spinning sector players. Around one-third of the total company's sales revenue was contributed by the cotton segment in 1QFY19 at Rs. 370.8m (1QFY18: Rs. 13.4m).

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. Investment portfolio (excluding associates) comprises exposure in power, cement and other diversified sectors. Listed equity portfolio (excluding associates) amounted to Rs. 437m (FY17: 498m) as at end-FY18. CSAPL also has investment in associates (at cost) which amounted to Rs. 1.28b (Market value: Rs. 4.2b) at end-FY18. These include investments in Altern Energy Limited (AEL- Shares held 16.64%) and Shakarganj Limited (Shares held-21.93%). During FY18, income from the portfolio stood at Rs. 496m (FY17: Rs. 247m). Majority of the portfolio income emanated from dividend from investment in AEL. JCR-VIS expects investment income to continue to support bottom line over the term of the Sukuk.

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. Pipeline augmentation projects of gas utility companies and K-4 project are expected to support sales over the short-term but timely commencement of work on RLNG-3 pipeline or other major projects are important for supporting medium term sales. As the only major local large diameter spiral pipe of the Board of Directors of Pakistan Centre for Philanthropy.

manufacturer in the country, the company is well-positioned to capture a chunk of the new orders.

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. However, given the declining trend in steel prices, JCR-VIS expects margins to remain strong for FY19.

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
Topline of the company reported a decline of 31% to Rs. 7b (FY17: Rs. 10b) during FY18 on account of completion of orders in hand and delay in tendering for new projects. More than four-fifth of the revenues were contributed by the steel division while the remaining emanated from the cotton division. Gross margins of the company witnessed weakening in FY18 and stood at 11.5% (FY17: 18.2%) on account of rise in HRC prices. However, profitability of the company was supported by income from investments of Rs. 496m (FY17: Rs. 247m). Accounting for finance cost and taxes, the company reported profit after tax of Rs. 752m (FY17: Rs. 1b) during FY18. During 1QFY19, sales and profit after tax were reported at Rs. 1.6b and Rs. 4m, respectively. Projected improvement in order pipeline, improvement in gross margins, revival of cotton division and income from investments are projected to support profitability, going forward.

Performance of subsidiaries
During FY18 and 1QFY19, trend in losses persisted for CHL owing to yield losses, margin erosion due to company's inability to pass on the impact of higher scrap prices and scrap blending challenges which led to sub-optimal capacity utilization levels. CHL operated at lower capacity utilization rate of 59% (FY17: 75%) during FY18. Given lower capacity utilization of CHL, CSEL remained under-utilized resulting in higher losses. Resultantly, funding requirements of subsidiaries have increased. Going forward, with the management having achieved the right scrap mix capacity utilization levels are projected to improve with break-even targeted in the ongoing year. Funding requirement of subsidiaries has remained elevated on a timeline basis; performance of subsidiaries and funding requirements of the same will be an important rating driver.

Capitalization
The assigned ratings draw support from company's low leveraged capital structure. Gearing and leverage stood at 0.4x (FY18: 0.29x) and 0.53x (FY18: 0.50x) at end-1Q19. Borrowings are primarily short-term in nature and mobilized for working capital requirements and in order fund cash flow requirement of subsidiaries. At end-Sept'2018, debt levels of the company reported an increase to Rs. 2.6b (FY18: Rs. 1.9b). Equity base of the company has consistently grown on a timeline basis owing to retained profits and was reported at Rs. 6.7b (FY16: 5.8b) at end-FY18.

Liquidity
Funds flow from operations (FFO) followed a decreasing trend in FY18 and 1QFY19. Consequently, cash flow coverage of outstanding debt declined. However, liquid investments carried on balance sheet support assessment of company's liquidity profile. At end-September'2018, stock-in-trade and trade debts do not provide sufficient coverage to short term borrowings indicating mis-match on balance sheet. Going forward, with materialization of sales orders, cash flows and liquidity profile is projected to improve.

Sukuk
In order to re-profile existing debt on balance sheet and address maturity mismatch, management intends to raise a Sukuk amounting to Rs. 1b (inclusive of a green shoe-option of Rs. 200m). Funds

raised from the Sukuk will primarily be utilized for re-profiling of the balance sheet and retiring existing short-term debt in order to make funds available for working capital requirements of upcoming projects. Security features of the Sukuk entail first pari-passu charge on all present and future fixed assets of CHL and CSEL. Moreover, a debt servicing reserve account (DSRA) will be created whereby one peak quarterly installment (principal+profit) in advance will always remain deposited in the DSRA. Debt payment mechanism also entails progressively retaining upcoming installment so that debt payment account is equal to the installment.

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	FY18	1QFY19*
Fixed Assets	781	823	941	1,039	1,005
Long term Investments	3,038	3,935	4,204	4,538	4,538
Stock-in-Trade	453	2,267	2,687	1,543	1,145
Trade Debts	88	323	664	107	549
Cash & Bank Balances	43	63	28	133	11
Total Assets	5,393	9,484	12,180	10,079	10,297
Trade and Other Payables	638	850	2,002	1,349	834
Long Term Debt	388	639	568	497	522
Short Term Debt	302	2,084	2,517	1,458	2,136
Total Debt	689	2,723	3,086	1,955	2,658
Total Equity	4,051	5,808	6,820	6,724	6,729
INCOME STATEMENT					
Net Sales	2,102	7,412	10,209	7,044	1,645
Gross Profit	32	2,143	1,859	811	118
Income from Investments	309	43	247	496	(14)
Profit After Tax	106	967	1,012	752	4
RATIO ANALYSIS					
Gross Margin (%)	1.5%	28.9%	18.2%	11.5%	7.2%
Net Margin	5.1%	13.0%	9.9%	10.7%	0.3%
Net Working Capital	423	1,400	2,096	1,248	1,275
Trade debts/Sales	4%	4%	7%	2%	8%
FFO	180	1,773	1,518	474	21
FFO to Total Debt (%)	26%	65%	49%	24%	3%
FFO to Long Term Debt (%)	46%	277%	267%	95%	16%
Current Ratio (x)	1.4	1.4	1.4	1.4	1.4
Debt Servicing Coverage Ratio (x)	2.3	6.0	5.0	1.8	0.8
Gearing (x)	0.17	0.47	0.45	0.29	0.40
ROAA (%)	2%	13%	9%	7%	0.2%
ROAE (%)	3%	20%	16%	11%	0.3%

** Ratios Annualized*

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 & Sukuk Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
December 26, 2018	A	A-2	Stable	Downgrade
May 29, 2018	A+	A-2	Negative	Maintained
July 03, 2017	A+	A-2	Stable	Initial
RATING TYPE: SUKUK				
December 26, 2018	A+		Stable	Preliminary

Instrument Structure	Sukuk amounting to Rs. 1b (inclusive of a green shoe-option of Rs. 200m). Tenor of the Sukuk will be 5 years (inclusive of 1 year grace period) with the instrument carrying profit rate of 185bps over the benchmark rate. Funds raised from the Sukuk will primarily be utilized for re-profiling of the balance sheet and retiring existing short-term debt in order to make funds available for working capital requirements of upcoming projects. Security features of the Sukuk entail first pari-passu charge on all present and future fixed assets of the subsidiaries. Moreover, a debt servicing reserve account (DSRA) will be created whereby one peak quarterly installment (principal+ profit) in advance will always remain deposited in the DSRA.
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.
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