

## RATING REPORT

## Crescent Steel &amp; Allied Products Limited

**REPORT DATE:**

December 13, 2023

**RATING ANALYSTS:**

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## RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-Term	Short-term	Long-Term	Short-term
<b>Entity</b>	A-	A-2	A-	A-2
<b>Rating Date (Entity)</b>	December 13, 2023		March 31, 2023	
<b>Rating Outlook (Entity)</b>	Stable		Rating Watch-Negative	
<b>Rating Action (Entity)</b>	Maintained		Maintained	
<b>Sukuk</b>	A-		A-	
<b>Rating Date (Sukuk)</b>	December 13, 2023		March 31, 2023	
<b>Rating Outlook (Sukuk)</b>	Stable		Rating Watch-Negative	
<b>Rating Action (Sukuk)</b>	Maintained		Maintained	

## COMPANY INFORMATION

<b>Incorporated in 1983</b>	<b>External auditors:</b> M/s. A.F. Ferguson & Co Chartered Accountants
<b>Public Listed Company</b>	<b>Chairman of the Board:</b> Mr. Ahmad Waqar
<b>Key Stakeholders (with stake 5% or more):</b>	<b>Chief Executive Officer:</b> Mr. Ahsan M. Saleem
<i>Local Public – 43.82%</i>	
<i>Other Companies (Local and Foreign) – 28.28%</i>	
<i>Associated Companies, Undertakings, and Related Parties – 9.99%</i>	
<i>Banks, DFIs, and NBFCs – 9.17%</i>	

## APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2023)

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

## APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

## Crescent Steel & Allied Products Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p><b>Crescent Steel &amp; Allied Products Limited</b> was incorporated on August 1, 1983, as a public limited company listed on the Pakistan Stock Exchange (PSX). It is a conglomerate with predominantly operations in Steel manufacturing.</p> <p><b>Chairman's Profile: Mr. Ahmad Waqar</b> is the Chairman of CSAP. He used to be a member of the Policy Board, Dept. of Auditor General Pakistan. Mr. Waqar has diverse experience across entities in both the Public and Private Sector.</p> <p><b>CEO's Profile: Mr. Ahsan M. Saleem</b> has been the Chief Executive Officer and Managing Director of Crescent Steel &amp; Allied Products Limited since its inception. He has over 35 years of extensive industry experience in managing multiple business operations across variety of sectors such as steel, sugar, power, textile, and engineering.</p>	<p><b>Corporate Profile</b></p> <p>Crescent Steel and Allied Products Limited ('CSAP' or 'the Company') was established on August 1, 1983, as a public limited company in Pakistan. CSAP is publicly listed on the Pakistan Stock Exchange and has a registered office at E-floor, IT Tower, 73-E/1, Hali Road, Gulberg-III, Lahore. The Company's principal office is located on the 9th floor of Sidco Avenue Centre, 264 R. A. Lines, Karachi.</p> <p>Following are the various divisions of CSAP:</p> <p><b>Steel Segment:</b> In this sector, the Company produces large-diameter spiral arc-welded steel line pipes at a facility situated in Nooriabad, District Jamshoro, Sindh. CSAP also runs a coating facility capable of applying three layers of high-density polyethylene coating to steel line pipes. The coating plant commenced its commercial operations on November 16, 1992. Additionally, the Company operates a fabrication unit engaged in machinery fabrication and erection, located in Dalowal, District Faisalabad, Punjab.</p> <p><b>Cotton Spinning Unit:</b> CSAP manages a cotton-spinning unit in Jaranwala, District Faisalabad, operating under the name "Crescent Cotton Products," as another division of the Company.</p> <p><b>Investment and Infrastructure Division:</b> The Company oversees a portfolio of equity investments and real estate through its Investment and Infrastructure Division, based at its principal office.</p> <p><b>Hadeed (Billet) Segment:</b> With Hadeed (Billet) Segment, CSAP expands its operations into the long steel products business. The billets produced in this segment are supplied to re-rolling mills for the manufacturing of bars and other steel long products used in construction and engineering. The plant for this segment is located in Bhone, District Jhang, Punjab.</p> <p><b>Energy Segment:</b> In the energy sector, CSAP is involved in constructing, owning, operating, and maintaining a power plant for generating, distributing, selling, and supplying electricity and power. The primary function of the unit is to provide energy to the Hadeed Division. Any surplus energy is provided to Pakistan Electric Power Company (PEPCO) and Distribution Companies (DISCOs), as agreed upon with the Government of Pakistan. The power generation plant uses bagasse in the combustion process to produce power and processed steam. The plant for this segment is also situated in Bhone, District Jhang, Punjab.</p> <p><b>Key Rating Drivers</b></p> <p><b>Characterized by sensitivity to economic cyclicalities and exposure to fluctuation in exchange rates and international commodity prices.</b></p> <p>VIS considers the business risk profile of the steel pipes &amp; tubes industry to be 'High', largely due to its susceptibility to fluctuations in economic environment and dependence on various factors such as raw material prices, exchange rates, inflation, and financing costs. Moreover, the industry is competitive with ~50 plus units operating across the country. However, out of which only two are listed on the Pakistan Stock Exchange (PSX).</p> <p>A significant portion of the raw material costs for pipe manufacturing involves the procurement of Hot Rolled Coils (HRC), primarily imported from countries such as China. These coils are processed into</p>

pipes through continuous or semi-continuous production lines and tailored to meet customer requirements.

#### Major Business Risk Factors:

1. **Low-Capacity Utilization:** In recent years, companies operating in the tubular sector have been operating at reduced capacity utilization, reflecting diminished demand for tubular products. For instance, during FY23, the industry's combined capacity of pipes stood at approximately 785,000 metric tons, yet the actual utilization was only 146,174 metric tons, translating to a utilization rate of 18.6% in FY23, down from 22.0% in the previous year. Low demand resulted from economic recession, reduced new housing and infrastructure development projects, elevated steel prices, inflation, and higher financing costs.
2. **Revenue and Profitability:** The industry's revenue (as per listed clients) decreased from PKR 46,157 million in FY22 to PKR 32,068 million in FY23. Although steel pipe prices remained high during the year, lower demand led to reduced sales revenue. The sector remained profitable, with profits largely attributable to other income and income from investments rather than core operations.
3. **Taxation Challenges:** The steel sector is heavily taxed in Pakistan due to the importation of a significant portion of its raw materials. Custom duty, with additional regulatory duty, sales tax, income tax, and other levies impact steel product prices. The current tax structure is expected to persist going forward, necessitating efficient procurement and inventory management to sustain profitability.
4. **Higher Financing Costs:** Increased policy rates by the State Bank of Pakistan to control inflation have impacted industries heavily reliant on bank financing, including the steel sector. The higher policy rate has resulted in sharply rising finance costs for companies in the industry, with no significant rate reduction expected in the near term.
5. **Rupee Depreciation:** The substantial depreciation of the Pakistani Rupee (PKR) against the US Dollar has elevated working capital requirements for domestic manufacturers. This, coupled with higher benchmark rates, has increased finance costs for the steel industry.
6. **Gas and Electricity Price Increases:** Rising gas and electricity prices significantly influence sales and profitability in the steel sector. Recent rate hikes in both gas and electricity have led to increased unit prices for steel products, impacting sales and profitability.

The outlook for the steel sector remains uncertain in the short to medium term, with several challenges on the horizon, including macroeconomic concerns, inflation, raw material costs, energy expenses, exchange rate fluctuations, and high financing rates. Industry reforms and government support for fuel prices, inventory management, energy-efficient machinery, import restrictions, and anti-dumping measures will be crucial for reviving the sector's outlook.

#### CSAP's diversified revenue stream diluting with its billet and electricity segment halting down.

CSAP's revenue stream is diversified through its various business segments including steel, cotton, investment, and energy. The steel segment primarily focuses on large-diameter spiral arc-welded steel line pipes, serving as the core operation, while the pre coating of steel pipes from different pipes manufacturers is also a part of this segment. The Company expanded its operations into the long-steel product business through the Hadeed (Billet) segment. The Hadeed segment is supported by the energy division which provides it with continuous flow of cost-efficient energy. However, as a result of dampened demand and difficulty in obtaining LCs the Company decided to halt production of its billet segment in FY23. This also led to non-operation of the energy division.

The Company also operates in the cotton-spinning segment, which experienced a decline with capacity utilization decreasing to 26% in FY23 from 93% in FY22. Meanwhile, its Investment and Infrastructure Division, responsible for managing equity investments and real estate, continued to provide support to the Company's bottom line during the period under review.

Despite its diversified businesses, in recent years as a result of instability in the economy CSAP has been unable to benefit from its diversification. Some of CSAP segments have resulted in being a drag on profitability resulting in volatile margins over the years. As per the management medium long-term goal is to revise their investment strategy into more profitable avenues.

**Overall contraction in revenue in FY23 on account of weak economic environment. However, core business strengthened with ongoing contracts and is expected to remain stable in FY24.**

In FY23, CSAP witnessed a 36% decrease in gross sales due to nil billet sales (FY22: PKR 2,858 mln) and a substantial 63% decline in cotton yarn sales, primarily influenced by prevailing economic conditions. Cotton yarn sales were reported at PKR 1,153 mln (FY22: PKR 3,125 mln) in FY3. Nevertheless, sales of bare pipes, pipe coating, and coated pipes surged by 176% and supported overall topline. This increase came from contracts with Sui Northern Gas Pipelines Limited (SNGPL) and China Harbour Engineering Company - Al Fajr International Joint Venture Company (CHEC – AFIJVC), for the K-IV Greater Karachi Bulk Water Supply Project. The customer supplied major raw materials for this project, contributing to the Company's improved margins. Gross margins continued to rise in 3MFY24, driven by lower HRC prices compared to FY23.

During FY23, net margins were constrained by higher finance costs, mainly due to an 825-bps increase in the policy rate over the year. However, 3MFY24 saw a substantial net margin increase, attributed to a surge in investment income, including considerable dividend earnings of PKR 203 mln.

Management expects to fulfill the remaining K-IV project orders in FY24, as well as continued gas utility orders, which is anticipated to support overall turnover of the Company. Additionally, they intend to retain investments in strong Pakistan corporate entities within the capital markets.

**Conservative debt profile continues to provide comfort to assigned ratings.**

Ratings draw comfort from the Company's conservative financial management, maintaining reasonable levels of gearing and leverage indicators. However, the issuance of Sukuk and increased utilization of short-term debt to address rising working capital needs resulted in total debt rising to PKR 2,391 million in 3MFY24 (FY23: PKR 2,061 million, FY22: PKR 1,065 million). Consequently, gearing and leverage ratios experienced a marginal increase to 0.4x (FY23: 0.3x, FY22: 0.2x) and 0.7x (FY23: 0.6x, FY22: 0.4x), respectively, in 3MFY24.

**Company's liquidity and coverage profile remain adequate; however, the coverage profile is sensitive to CSAP's profitability. Maintenance of profitability and FFO to be key considerations going forward.**

Historically, Fund from Operations (FFO) for Crescent Steel & Allied Products Limited has shown variability in tandem with the Company's profitability. The notable surge in Debt Servicing Coverage Ratio (DSCR) in 3MFY24 is attributed to improved cash inflow from operations and higher dividend income received, thereby positively impacting both FFO to total debt and the overall coverage profile. This spike in dividend income is expected to normalize going forward. Nonetheless, the Company maintains a sound coverage profile regardless of dividend income.

Meanwhile, the liquidity profile remains adequate in 3MFY24 with a current ratio of 1.3x (FY23: 1.3x, FY22: 1.4x). Moreover, Stock in Trade and Trade Debts continue to provide sufficient coverage for short-term borrowings, at 1.9x in 3MFY24 (FY23: 1.3x, FY22: 1.7x).

**Key Considerations for Future Ratings:**

Going forward, translation of order in hand into sales up to the extent as planned by year-end FY24 will be an important consideration. In addition, materialization of the remaining tonnage of expected tenders and sufficient fresh orders to sustain CSAP's operations will be key sensitivity for future ratings.

**Crescent Steel & Allied Products Limited**
**Appendix I**

<b>FINANCIAL SUMMARY</b>		<b>(PKR Millions)</b>			
<b><u>BALANCE SHEET</u></b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>3MFY24A</b>	
Property, plant and equipment	1,927.3	2,107.2	2,437.6	2,397.0	
Stock-in-trade	1,236.5	1,190.1	1,269.0	1,741.0	
Trade debts	137.1	175.2	464.0	1,326.0	
Cash and bank balances	4.0	6.7	30.3	280.0	
Total Assets	8,705.7	8,445.1	9,948.3	10,940.0	
Trade and Other Payables	755.2	1,136.9	1,389.1	1,679.4	
Long-term Debt (incl. current portion and lease liability)	397.6	252.1	771.6	766.1	
Short term borrowings	1,514.9	812.6	1,289.5	1,624.5	
Total Debt	1,912.6	1,064.8	2,061.2	2,390.7	
Total Liabilities	2,734.7	2,346.7	3,828.8	4,496.1	
Paid up Capital	1,797.2	1,797.2	1,797.2	1,797.2	
Equity (excl. Revaluation Surplus)	5,970.8	6,098.4	6,119.4	6,444.2	
<b><u>INCOME STATEMENT</u></b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>3MFY24A</b>	
Net Sales	7,259.3	7,089.9	4,515.6	1,346.8	
Gross Profit	496.7	-65.3	775.9	326.7	
Operating Profit	208.4	-470.2	307.4	207.6	
Finance Costs	210.8	246.2	360.0	129.9	
Profit Before Tax	426.5	315.1	234.3	413.6	
Profit After Tax	351.9	366.7	176.9	325.1	
<b><u>RATIO ANALYSIS</u></b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>3MFY24A</b>	
Gross Margin (%)	6.8%	-0.9%	17.2%	24.3%	
Net Margin (%)	4.8%	5.2%	3.9%	24.1%	
Funds from Operation (FFO)	333.2	864.7	422.3	609.9	
FFO to Total Debt* (%)	17.4%	81.2%	20.5%	102.1%	
FFO to Long Term Debt* (%)	83.8%	342.9%	54.7%	318.5%	
Gearing (x)	0.3	0.2	0.3	0.4	
Leverage (x)	0.5	0.4	0.6	0.7	
Debt Servicing Coverage Ratio* (x)	1.3	2.9	1.214	3.7	
Current Ratio	1.4	1.4	1.3	1.3	
(Stock in trade + trade debts) / STD (x)	0.9	1.7	1.3	1.9	
Return on Average Assets* (%)	3.8%	4.3%	1.9%	12.5%	
Return on Average Equity* (%)	6.2%	6.1%	2.9%	20.7%	

\*Annualized, if required

REGULATORY DISCLOSURES					Appendix II
<b>Name of Rated Entity</b>	Crescent Steel & Allied Products Limited				
<b>Sector</b>	Steel Industry				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b><u>RATING TYPE: ENTITY</u></b>				
	13-Dec-23	A-	A-2	Stable	Maintained
	31-Mar-23	A-	A-2	Rating Watch - Developing	Maintained
	11-Oct-22	A-	A-2	Stable	Reaffirmed
	25-Jun-21	A-	A-2	Stable	Reaffirmed
	08-Apr-20	A-	A-2	Stable	Downgrade
	26-Dec-18	A	A-2	Stable	Downgrade
	29-May-18	A+	A-2	Negative	Maintained
	03-Jul-17	A+	A-2	Stable	Initial
	<b><u>RATING TYPE: SUKUK</u></b>				
	13-Dec-23	A-	-	Stable	Maintained
	31-Mar-23	A-	-	Rating Watch – Developing	Maintained
	24-Oct-22	A-	-	Stable	Final
	08-Dec-21	A-	-	Stable	Preliminary
<b>Instrument Structure</b>	CSAP has issued a privately placed Sukuk of Rs. 800m to meet its working capital needs. The Sukuk has a tenor of three years with six equal installments of principal redemption starting from the 6th month of drawdown. The pricing of the issue is 6M-KIBOR plus 2% spread. Security structure of the Sukuk entails ranking charge on Fixed Assets/constructive mortgage charge. Moreover, a collection account will be maintained with the collection Bank which will be funded for the entire installment amount 20 days prior to the payment date.				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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<b>Due Diligence Meetings Conducted</b>	<b>S.No.</b>	<b>Name</b>	<b>Designation</b>	<b>Date</b>	
	1.	Mr. Muhammad Saad Thania	Chief Financial Officer	20-Nov-23	
	2.	Mr. Azeem Sarwar	Senior Manager Finance & Company Secretary		
	3.	Mr. Hasan Imran Kazmi	Assistant Manager – Treasury & Sustainability Reporting		