



Alert on Q3 2013 Earnings

Sector: Basic Materials & Industrial Products

Country: Egypt

Date: February 27, 2014

Share Price (EGP): 17.80

Target Price (EGP): 19.78

Upside: 11.1%

Recommendation: ACCUMULATE

Top-line grows on continuous robust domestic demand

Ezz Steel revenues increased by 7.7% y-o-y to reach EGP 15.98 billion up to September 2013, supported by strong sales volumes and average selling prices. Long and flat products prices grew by a respective 8% and 4% in the domestic market, while flat export prices rose by 6%. Ezz sold 2.82 million tons of long products, an increase of 1% compared to a year earlier. Similarly, flat sales volumes, which are concentrated at Ezz El Dekhila (EZDK), edged up by 4% to 728 thousand tons. Local sales constituted around 84% of the Egyptian steel maker's top-line following robust local demand, while the remaining 16% were mostly attributed to export markets led by Europe and the MENA region. Similarly, revenues increased by 6.6% y-o-y during Q3 2013 to reach EGP 4.84 billion. We expect Ezz's top-line to reach EGP 21.02 billion in 2013, growing at a CAGR of 5.9% during the coming three years on solid domestic demand and attractive local pricing.

Sharp surge in earnings on higher operating efficiency

Ezz production costs dropped to 88.4% of sales during the first nine months of 2013 from 91.6% a year earlier, driving the company's gross profit by 48.7% up to EGP 1.8 billion with a gross margin of 11.6%. Earnings followed suit, jumping to EGP 218 million from a loss of EGP 46 million recorded a year earlier, additionally lifted by higher non-operating revenues, forex gains, and interest income despite the rise in SG&A expenses and borrowing costs. However, Ezz recorded a loss of EGP 84 million during Q3 but still narrower than the EGP 128 million registered a year earlier. The company endured a challenging quarter but we expect a profit in Q4 with an estimated 2013 bottom-line of EGP 292 million.

Positive medium-term outlook for the steel sector

The Egyptian steel industry continues to show signs of growth despite the economic downturn in the country. We expect demand for long and flat products to remain strong on the back of the economic stimulus package announced by the Egyptian government in November which will increase spending on infrastructure projects in addition to potential greater investments coming from Gulf countries who seek to diversify their regional portfolios in case the political transition unfolds in favor of Sissi. On a more positive note to steel producers, Egypt is planning to impose restrictions on the import of Turkish steel flooding the local market at lower prices. This will translate into enhanced status of Egyptian steel producers, largely benefiting Ezz due to its market leader position in Egypt's steel industry with a share of over 60%.

Maintain an ACCUMULATE on easing macroeconomic and political risks

We maintain an ACCUMULATE rating on Ezz steel, revising our target price up to EGP 19.78 per share on easing levels of political tensions and economic uncertainties. We incorporate in our model the enhancement of Ezz's profitability with the start of the direct-reduced iron factory at the end of 2014, which will save around \$50 to \$100 off the cost per ton produced. We expect the company to benefit from the continuous solid domestic demand supported by Egypt's strong demographic features in addition to the positive effect of the weaker Egyptian currency on its international sales. However, we continue to perceive pressures from the additional specific risks associated with the lawsuits filed against Ahmad Ezz and the ability of the company to hold on to its largest and most profitable subsidiary, EZDK.

Share Data

Bloomberg Symbol	ESRS EY
Reuters Symbol	ESRS.CA
Market Cap (EGP)	9,463,676,770
Number of Shares	543,265,027
Free Float	35%
Price-to-Earnings 2013e	32.46
Price-to-Book 2013e	1.37

Share Performance



Source: Reuters

1 Month Return	10.2%
3 Month Return	28.2%
6 Month Return	53.5%
12 Month Return	75.6%
52 Week Range	7.72 – 18.01

Source: Reuters

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Performance and Forecasts

In EGP millions	2010	2011	2012	2013f
Revenues	16,621	18,611	19,799	21,024
Gross Profit	1,923	2,207	1,690	2,313
Gross Profit Margin %	12%	12%	9%	11.0%
Net Income	251	202	8	292
Profit Margin %	2%	1%	0%	1.4%

Source: Ezz Steel, Blominvest

QUARTERLY INCOME STATEMENT

<i>In EGP million</i>	Q1'12	Q2'12	Q3'12	Q4'12	Q1'13	Q2'13	Q3'13
Net sales	5,195	5,111	4,538	4,955	5,581	5,561	4,840
Cost of goods sold	(4,720)	(4,586)	(4,296)	(4,507)	(4,821)	(4,899)	(4,414)
Gross Profit	475	525	243	448	760	662	426
Selling & marketing Exp.	(21)	(29)	(26)	(26)	(32)	(44)	(33)
General & Admin. Expenses	(74)	(87)	(103)	(108)	(117)	(129)	(151)
Impairment Loss on Assets	-	-	-	-	(0)	-	(7)
Provisions	-	-	-	-	(7)	(1)	(1)
Total expenses	(95)	(116)	(129)	(134)	(157)	(174)	(192)
Finance expenses	(206)	(207)	(224)	(242)	(236)	(216)	(207)
Interest income	8	12	8	15	18	24	28
Other income	3	31	(2)	113	115	61	(16)
Total other expenses	(195)	(164)	(219)	(114)	(104)	(131)	(195)
Net profit before tax & non-controlling interest	185	245	(106)	200	499	358	39
Income tax expense	(79)	(77)	(50)	(69)	(115)	(129)	(95)
Deferred tax expense	(43)	(25)	46	28	(13)	21	27
Net profit before minority interests	63	142	(110)	159	372	250	(29)
Minority interest	(45)	(79)	(18)	(100)	(169)	(151)	(55)
Net profit after minority interests	18	64	(128)	58	202	99	(84)

Source: Ezz Steel

PROJECTED INCOME STATEMENT

<i>In EGP million</i>	2010	2011	2012	2013e
Net sales	16,621	18,611	19,799	21,024
Cost of goods sold	(14,698)	(16,404)	(18,109)	(18,711)
Gross Profit	1,923	2,207	1,690	2,313
Selling & marketing Exp.	(154)	(113)	(102)	(137)
General & Admin. Expenses	(235)	(297)	(373)	(399)
Impairment Loss on Assets	(2)	(17)	(4)	(5)
Provisions	(95)	(81)	(2)	(10)
Total expenses	(486)	(509)	(480)	(551)
Finance expenses	(754)	(764)	(880)	(984)
Interest income	67	64	42	69
Other income	22	30	148	150
Total other expenses	(665)	(670)	(690)	(765)
Net profit before tax & non-controlling interest	772	1,028	520	997
Income tax expense	(171)	(359)	(275)	(269)
Deferred tax expense	(37)	(133)	5	20
Net profit before minority interests	564	536	250	747
Minority interest	(313)	(334)	(242)	(456)
Net profit after minority interests	251	202	8	292

Source: Ezz Steel, Blominvest

BALANCE SHEET

<i>In EGP million</i>	2010	2011	2012	Q3 2013
Non-current Assets				
Property, plant & equipment	9,567	9,937	11,127	11,238
Projects under construction	3,319	3,558	2,755	3,030
Goodwill	315	315	315	315
Other non-current assets	244	281	304	316
Total non-current assets	13,445	14,090	14,500	14,899
Current Assets				
Inventories	3,734	3,629	3,620	3,770
Trade & notes receivable	185	122	52	192
Debtors & other debit balances	586	628	924	1,098
Advances to suppliers	48	135	59	52
Investments in treasury bills	57	63	47	43
Cash & cash equivalents	1,415	1,171	1,290	1,675
Total current assets	6,025	5,747	5,991	6,831
Total Assets	19,470	19,837	20,492	21,730
Non-current Liabilities				
Loans	4,466	3,937	3,377	3,324
Other non-current liabilities	205	667	779	565
Bonds loan	651	433	216	217
Deferred tax liabilities	658	790	789	755
Total Non - current liabilities	5,980	5,828	5,161	4,862
Current Liabilities				
Banks credit accts & Overdrafts	1,136	1,003	2,061	2,424
ST Loans & Borrowings	3,292	3,573	4,203	4,236
Bonds loan	220	220	220	220
Installments due within one year	-	-	-	56
Trade & notes payable	1,145	1,364	1,413	1,855
Advances from customers	410	236	287	275
Creditors & other credit balances	677	389	359	415
Income Tax	-	359	275	339
Liability of the supplementary pension scheme	-	-	-	14
Provisions	123	204	205	202
Total Current Liabilities	7,003	7,349	9,023	10,036
Total Liabilities	12,983	13,177	14,184	14,897
Shareholders' Equity	6,487	6,661	6,307	6,833
Total Liabilities & Equity	19,470	19,837	20,492	21,730

Source: Ezz Steel

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Equity Rating Key

Recommendations are based on the upside (downside) between our 12-month Fair Value estimate and the current Market Price.

Buy: Fair Value higher than Market Price by at least 20%

Accumulate: Fair Value higher than Market Price by 10% to 20%

Hold: Fair Value ranges between -5% to +10% in relation to Market Price

Reduce: Fair Value lower than Market Price by 5% to 15%

Sell: Fair Value lower than Market Price by at least 15%

Risks are based on share price volatility along with qualitative factors such as the nature of the business, the country risk and sensitivity to a single event, single product or single buyer. We've arranged the risk factor into 5 trenches:

- High Risk
- Medium-to-High Risk
- Medium Risk (similar to Market Risk)
- Medium-to-Low Risk
- Low Risk

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