



## Alert on Q3 2011 Earnings

Sector: Basic Materials &amp; Industrial Products

Country: Egypt

Date: February 17, 2012

Share Price (EGP): 6.85

Fair Value (EGP): 6.50

Downside: 5%

Recommendation: Hold

Risk: High

**Resilient operations supported by continuous strong domestic demand**

Ezz Steel continues to showcase robust operations that seem to withstand the subdued macroeconomic environment in Egypt. The company reported a 22.4% y-o-y increase in revenues to EGP 14,165M during the first nine months of 2011, led by strong long product sales but mostly by persistent increase in steel prices. Sales of long steel, which continue to form the bulk of the revenue pool, rose by 5% y-o-y to 2.5M tons. These largely compensated for the 17% y-o-y drop in the flat steel sales to 0.82M tons, as foreign demand is shattered by the economic wobbles in Europe, the company's largest flat steel export market, but also as Ezz suspended flat steel production at its EFS facility to focus on long products.

**Bottom line distressed by non-operating expenses**

With production costs flat at 88% of sales margin, the gross profit at Ezz improved by 20% y-o-y during the first nine months of the year to EGP 1,712M and operating margin stayed at 10% of top line. Yet net income for the period fell by 11% y-o-y to EGP 450M pressured by a 5% y-o-y increase in net finance expenses. The biggest hit to earnings resulted however from the increase in corporate tax rate from 20% to 25% that took effect during the year. This ensued in a twofold y-o-y jump in related charges, including a one-off flop to earnings from an adjustment to deferred tax liability. If this item were ignored, the net margin would stand at 4.1% compared to 4.4% for the same period in 2010, instead of 3.2% under current conditions. Further, net profit for the period would have increased by 16% y-o-y to EGP 585M instead of the 11% drop during the first nine months.

**Maintaining a HOLD rating on macroeconomic uncertainty**

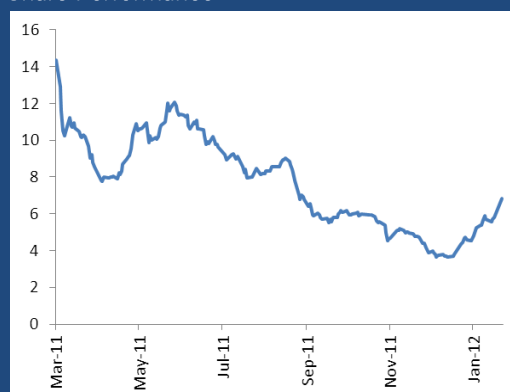
We revised our fair value upward to EGP 6.50 from EGP 4.30 previously, after slightly revising our 2012 revenue forecast upward with a 1.5% y-o-y increase. Most of the fair value revision comes however from adjusting the WACC to 24% instead of the 32% we applied previously. This came as the risk related to the legal results on the EZDK acquisition case declined after a court ruling confirmed that Talaat Moustafa's Madinaty contract is in compliance with Egyptian laws. The ruling slightly eased investors' concerns about the legal consequences on companies that were close to the ousted Mubarak regime. In addition, Ezz's debt decreased by 3.3% y-o-y and the long term debt-to-equity ratio fell to 69% during the period, down from 79% for 2010, contributing to lower risk on the steel maker's balance sheet.

We believe that although the political impasse will still significantly weigh on investment initiatives over the short to medium term, the continuous domestic demand backed by Egypt's strong demographic features will ensure a humble operational improvement this year.

## Share Data

Bloomberg Symbol	ESRS EY
Reuters Symbol	ESRS.CA
Market Cap (EGP)	3,721,365,435
Number of Shares	543,265,027
Free Float	35%
Price to 2010 Earnings	14.8
Price to 2010 Book	0.6

## Share Performance



Source: Reuters

1 Month Return	57.11%
3 Month Return	23.87%
6 Month Return	-14.27%
12 Month Return	-52.23%
52 Week Range (EGP)	3.64 – 14.34

Source: Reuters

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## Performance and Forecasts

In EGP millions	Q3 11	Q3 10	% QoQ	9M 11	9M 10	% YoY
Revenues	4,830	4,064	19%	14,165	11,570	22%
EBIT	493	229	115%	1,412	1,134	24%
EBIT Margin %	10.2%	5.6%		10.0%	9.8%	
Net Income	265	23	1,052%	450	507	-11%
Profit Margin %	3.2%	4.4%		5.5%	0.6%	

Source: Ezz Steel

## PROJECTED INCOME STATEMENT

<i>In EGP million</i>	2009	2010	2011e	2012f	2013f	2014f
Net sales	12,589	16,621	17,656	17,914	19,263	20,940
Cost of goods sold	(11,135)	(14,698)	(15,537)	(15,729)	(16,990)	(18,427)
<b>Gross Profit</b>	<b>1,455</b>	<b>1,923</b>	<b>2,119</b>	<b>2,186</b>	<b>2,273</b>	<b>2,513</b>
Selling & marketing expenses	(128)	(154)	(212)	(233)	(270)	(251)
General & admin. Expenses	(274)	(235)	(247)	(251)	(231)	(272)
Impairment loss on assets	(5)	(2)	-	-	-	-
Provisions	(15)	(95)	(100)	(75)	-	-
<b>Total expenses</b>	<b>(422)</b>	<b>(486)</b>	<b>(559)</b>	<b>(559)</b>	<b>(501)</b>	<b>(524)</b>
Finance expenses	(779)	(754)	(869)	(826)	(818)	(888)
Interest income	89	67	84	120	106	102
Other income	154	22	20	20	20	20
<b>Total other expenses</b>	<b>(536)</b>	<b>(665)</b>	<b>(765)</b>	<b>(686)</b>	<b>(693)</b>	<b>(766)</b>
<b>Net profit before tax &amp; non-controlling interest</b>	<b>497</b>	<b>772</b>	<b>795</b>	<b>941</b>	<b>1,079</b>	<b>1,223</b>
Income tax expense	(141)	(171)	(199)	(235)	(270)	(306)
Deferred tax expense	(49)	(37)	(150)	(60)	(60)	(60)
<b>Net profit before minority interests</b>	<b>307</b>	<b>564</b>	<b>446</b>	<b>645</b>	<b>750</b>	<b>857</b>
Minority interest	(219)	(313)	(228)	(342)	(405)	(472)
<b>Net profit after minority interests</b>	<b>88</b>	<b>251</b>	<b>219</b>	<b>303</b>	<b>345</b>	<b>386</b>

Source: Ezz Steel, Blominvest

## PROJECTED BALANCE SHEET

<i>In EGP million</i>	2009	2010	9M2011	2012f	2013f	2014f
<b>Non-current Assets</b>						
Property, plant & equipment	9,627	9,567	9,998	10,084	10,467	10,855
Projects under construction	1,427	3,319	3,311	3,542	4,005	1,692
Goodwill	315	315	315	315	315	315
Other non-current assets	25	198	271	6	8	5
<b>Total non-current assets</b>	<b>11,393</b>	<b>13,399</b>	<b>13,895</b>	<b>13,948</b>	<b>14,796</b>	<b>12,867</b>
<b>Current Assets</b>						
Inventories	2,679	3,734	4,191	3,404	3,371	3,350
Trade & notes receivable	112	185	192	233	289	272
Debtors & other debit balances	694	617	622	573	578	628
Advances to suppliers	132	48	34	179	212	209
Investments in treasury bills	11	58	61	380	380	380
Cash & cash equivalents	1,581	1,415	1,346	1,612	1,734	1,885
<b>Total current assets</b>	<b>5,208</b>	<b>6,057</b>	<b>6,446</b>	<b>6,381</b>	<b>6,563</b>	<b>6,725</b>
<b>Total Assets</b>	<b>16,601</b>	<b>19,455</b>	<b>20,341</b>	<b>20,329</b>	<b>21,359</b>	<b>19,592</b>
<b>Non-current Liabilities</b>						
Loans	3,547	4,466	3,988	3,775	3,398	3,685
Other non-current liabilities	114	205	235	270	311	357
Bonds loan	880	651	543	323	112	-
Deferred tax liabilities	621	658	813	888	977	1,064
<b>Total Non - current liabilities</b>	<b>5,162</b>	<b>5,980</b>	<b>5,579</b>	<b>5,256</b>	<b>4,797</b>	<b>5,107</b>
<b>Current Liabilities</b>						
Banks credit accts & Overdrafts	1,498	1,136	913	1,416	1,563	1,658
ST Loans & Borrowings	1,654	3,292	3,782	3,146	3,058	3,317
Bonds loan	220	220	220	220	220	220
Trade & notes payable	860	1,145	1,708	1,022	1,053	1,087
Advances from customers	365	410	284	717	751	733
Creditors & other credit balances	531	662	1,188	928	1,053	1,106
Provisions	38	123	127	52	53	50
<b>Total Current Liabilities</b>	<b>5,165</b>	<b>6,988</b>	<b>8,222</b>	<b>7,500</b>	<b>7,752</b>	<b>8,172</b>
<b>Total Liabilities</b>	<b>10,327</b>	<b>12,968</b>	<b>13,801</b>	<b>12,756</b>	<b>12,549</b>	<b>13,279</b>
<b>Shareholders' Equity</b>	<b>6,274</b>	<b>6,487</b>	<b>6,540</b>	<b>7,573</b>	<b>8,810</b>	<b>6,313</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>16,601</b>	<b>19,455</b>	<b>20,341</b>	<b>20,329</b>	<b>21,359</b>	<b>19,592</b>

Source: Ezz Steel, Blominvest



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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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