



Alert on H1 2011 Earnings

Sector: Basic Materials & Industrial Products

Country: Egypt

Date: December 27, 2011

Share Price (EGP): 3.70

Fair Value (EGP): 4.30

Upside: 16.5%

Recommendation: Hold

Risk: High

Updating with a fair value of EGP 4.30 and a HOLD recommendation on uncertainty surrounding the macroeconomic environment

Operations shielded by robust domestic demand

Ezz Steel reported a 24% y-o-y jump in revenues in H1 to EGP 9,334M, led by strong private residential construction activity despite the commotions in the local market during the first few months of the year. The wobbly economy that has been following the political uprisings had us channeling our expectations towards a slowdown in operations. Sales of long steel which almost fully serves the domestic market and constitutes the larger component of the revenue pool rose by 6% y-o-y to 1.6 million tons. This largely offset the 11% y-o-y decline in the flat steel sales to 0.6 million tons as production was disrupted by the political cataclysm. In addition, steel prices witnessed a remarkable hike in both local and export markets during the period, further backing the increase in the company's top line.

Earnings shattered by non-operating expenses and deferred-tax liability

The hike in both scrap and iron ore ate out the gross profit which edged up by 1.5% y-o-y to EGP 1,110M, sending the gross margin down to 12% from 14.6% in H1 2010. The operating income followed suit, also increasing by 1.5% to EGP 919M while the margin declined to 9.8% down from 12.1% last year. Non-operating expenses including net borrowing costs, foreign exchange losses and an increase in corporate tax rate 20% to 25% further pressured the net profit margin down to 2% from 6.4% in H1 2010. Still, the biggest hit to earnings came from a one-off deferred tax liability adjustment that if ignored, would slightly lift the net margin to 3.7%. This item sent the H1 net profit down by 62% y-o-y to EGP 185M instead of the 29% drop that would result if it were ignored.

Maintaining a HOLD rating on the high risks surrounding the stock

We considerably reduce the fair value to EGP 4.3 from EGP 9.5 previously as the situation in Egypt continues to deteriorate due to the political deadlock in the country. Most of the fair value adjustment is due to applying a WACC of 32%, which is 15% higher than our previous WACC used during normal business conditions. The 15% increment accounts for (1) depreciation of the Egyptian Pound which has already depreciated by 7% and is expected to continue doing so throughout 2012 (2) Additional risk for investing in Egypt during extremely uncertain times (3) A highly leveraged balance sheet which further magnifies the risk of investing in Ezz Steel (4) Legal disputes surrounding steel licenses and the EZDK acquisition. As for the financial forecasts, we have reduced our 2012 top-line estimates on the doubtful economic outlook of Egypt in the short run. Many construction projects may experience considerable delay as investors adopt a wait-and-see approach.

Share Data

Bloomberg Symbol	ESRS EY
Reuters Symbol	ESRS.CA
Market Cap (EGP)	2,010,080,600
Number of Shares	543,265,027
Free Float	35%
Price-to-Earnings 10	8.27
Price-to-Book 10	0.32

Share Performance



Source: Reuters

1 Month Return	-14.76%
3 Month Return	-42.92%
6 Month Return	-65.99%
12 Month Return	-79.17%
52 Week Range	3.87 – 21.96

Source: Reuters

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Performance and Forecasts

In EGP millions	Q2 11	Q2 10	% QoQ	H1 11	H1 10	% YoY
Revenues	4,946	4,097	21%	9,334	7,506	24%
EBIT	450	473	-5.0%	919	905	1.5%
EBIT Margin %	9.1%	11.5%		9.8%	12.1%	
Net Income	169	204	-17%	185	484	-62%
Profit Margin %	3.4%	5.0%		2.0%	6.4%	

Source: Ezz Steel

PROJECTED INCOME STATEMENT

<i>In EGP million</i>	2009	2010	2011e	2012f	2013f	2014f
Net sales	12,589	16,621	17,526	16,415	18,474	20,279
Cost of goods sold	(11,135)	(14,698)	(15,423)	(14,412)	(16,294)	(17,845)
Gross Profit	1,455	1,923	2,103	2,003	2,180	2,433
Selling & marketing expenses	(128)	(154)	(210)	(213)	(259)	(243)
General & admin. Expenses	(274)	(235)	(245)	(230)	(222)	(264)
Impairment loss on assets	(5)	(2)	-	-	-	-
Provisions	(15)	(95)	(100)	(75)	-	-
Total expenses	(422)	(486)	(556)	(518)	(480)	(507)
Finance expenses	(779)	(754)	(993)	(831)	(935)	(1,039)
Interest income	89	67	112	111	102	99
Other income	154	22	20	20	20	20
Total other expenses	(536)	(665)	(800)	(699)	(813)	(920)
Net profit before tax & non-controlling interest	497	772	747	785	887	1,007
Income tax expense	(141)	(171)	(187)	(196)	(222)	(252)
Deferred tax expense	(49)	(37)	(150)	(60)	(70)	(65)
Net profit before minority interests	307	564	410	529	595	690
Minority interest	(219)	(313)	(209)	(280)	(321)	(379)
Net profit after minority interests	88	251	201	248	274	310

Source: Ezz Steel, Blominvest

PROJECTED BALANCE SHEET

<i>In EGP million</i>	2009	2010	2011e	2012f	2013f	2014f
Non-current Assets						
Property, plant & equipment	9,627	9,567	9,212	9,369	9,786	10,193
Projects under construction	1,427	3,319	3,088	3,319	3,782	1,469
Goodwill	315	315	315	315	315	315
Other non-current assets	25	198	8	6	8	5
Total non-current assets	11,393	13,399	12,623	13,009	13,891	11,982
Current Assets						
Inventories	2,679	3,734	3,593	3,119	3,233	3,245
Trade & notes receivable	112	185	193	213	277	264
Debtors & other debit balances	694	617	580	525	554	608
Advances to suppliers	132	48	210	164	203	203
Investments in treasury bills	11	58	380	380	380	380
Cash & cash equivalents	1,581	1,415	1,490	1,477	1,663	1,825
Total current assets	5,208	6,057	6,446	5,879	6,310	6,525
Total Assets	16,601	19,455	19,069	18,888	20,201	18,507
Non-current Liabilities						
Loans	3,547	4,466	4,627	4,324	4,888	5,354
Other non-current liabilities	114	205	225	246	271	299
Bonds loan	880	651	431	211	-	-
Deferred tax liabilities	621	658	717	783	862	939
Total Non - current liabilities	5,162	5,980	6,000	5,564	6,021	6,591
Current Liabilities						
Banks credit accts & Overdrafts	1,498	1,136	1,465	1,297	1,499	1,606
ST Loans & Borrowings	1,654	3,292	3,393	2,882	2,933	3,212
Bonds loan	220	220	220	220	220	220
Trade & notes payable	860	1,145	1,049	937	1,010	1,053
Advances from customers	365	410	684	657	720	710
Creditors & other credit balances	531	662	879	850	1,010	1,071
Provisions	38	123	43	52	53	50
Total Current Liabilities	5,165	6,988	7,732	6,895	7,445	7,922
Total Liabilities	10,327	12,968	13,732	12,459	13,466	14,513
Shareholders' Equity	6,274	6,487	5,336	6,429	6,735	3,993
Total Liabilities & Shareholders' Equity	16,601	19,455	19,069	18,888	20,201	18,507

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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