



## Stock falls in “AVOID LIST” due to uncertainty surrounding chairman and the regulatory environment for Ezz Steel

### Downgrade recommendation to SELL with a fair value of EGP 14.22

|                                                         |                   |
|---------------------------------------------------------|-------------------|
| Share Price (in EGP):<br>Last Closing: January 27, 2011 | 16.00             |
| Fair Value Estimate (in EGP)                            | 14.22             |
| Bloomberg / Reuters Symbol:                             | ESRS EY / ESRS.CA |

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#### Downgrade fair value to 14.22 on weaker sales outlook and additional discount rate premium

We lower our sales forecasts during 2011 and 2012 to account for the dramatic challenges that are sweeping Egypt and the entire Middle East. Revenues in 2011 and 2012 are considerably reduced mainly due to lower capacity utilization during 2011 and 2012 driven by weaker local and regional demand than anticipated.

| Period          | Performance Indicator     | 2010      | 2011          | 2012          |
|-----------------|---------------------------|-----------|---------------|---------------|
| Pre-Revolution  | Revenue (in billion EGP)  | 14.6      | 20.0          | 22.4          |
| Post-Revolution | Revenue (in billion EGP)  | 14.6      | 15.8          | 20.0          |
|                 | <b>Change</b>             | <b>0%</b> | <b>-21%</b>   | <b>-10.5%</b> |
| Pre-Revolution  | Earnings (in million EGP) | 290       | 723           | 1,103         |
| Post-Revolution | Earnings (in million EGP) | 290       | 570           | 994           |
|                 | <b>Change</b>             | <b>0%</b> | <b>-21.3%</b> | <b>-9.8%</b>  |
| Pre-Revolution  | EPS (in EGP)              | 0.53      | 1.33          | 2.04          |
| Post-Revolution | EPS (in EGP)              | 0.53      | 1.05          | 1.83          |

Source: Blominvest

Investor risk perception of Egyptian equities has definitely changed after the current events and as such, we adjust the discount rate by adding 4% to the previously calculated WACC of 13% in order to account for the additional risk resulting in 17%.

Another key valuation metric that we updated is the terminal growth rate use in capturing the company's value after our 5 year forecasts. Previously, we used a 5% terminal growth rate in our valuation due to the dominant market position of Ezz and its plans to continuously increase its DRI capacity. This has been updated to 4% as we expect regulatory changes to be implemented that would disrupt the dominant position of Ezz.

With all the changes above, our fair value estimate for Ezz Steel is EGP 14.22 per share compared to the last closing price of EGP 16.00 on January 27, 2011. Note that while short term pressure appears to drive the stock - this is our 12 month view for the share price based on forecasts and taking into consideration the uncertainty surrounding new industry regulations that may drag.

A major non-financial assumption is that corruption allegations and the asset freeze applied against Ahmed Ezz, the chairman of Ezz Steel, do not affect the company's assets or operation.

## Ezz Steel Analyst Comment

Additionally, the regulatory environment for steel licensing is expected to be updated with the most significant impact on Ezz Steel being its ability to hold on to its subsidiary Ezz El Dekhila (Ticker: IRAX CA), which has a capacity of 3 million tons (more than half of total capacity at Ezz). It is worth noting that the Egyptian government owns 40% of Ezz El Dekhila while Ezz Steel owns 55% leaving 5% for public trading.

### Chairman personal assets are frozen without affecting company assets

Corruption allegations against the company's chairman, Ahmed Ezz, are yielding considerable uncertainty surrounding the company and its stock valuation.

On a personal level, Ahmed Ezz presided over the National Democratic Party's election campaign this last November and is charged with election rigging. He is known to be among the wealthiest and most powerful personalities in Egypt, closely associated with Mubarak's son and currently being investigated that he uses his connections to protect the dominant position of his company. His personal assets, such as real estate and cash, have been frozen and his right to travel is currently denied. The prosecution clearly stated that only personal assets and not those of the companies he owns share in would be frozen; therefore we expect no impact on Ezz's operation from these charges.

Ezz stock to endure short-term pressure related to news on chairman and would therefore trade at a further discount to Egyptian equities.

### Corrective measures related to steel licensing and market structure are set to arise

On the business front, the former Trade Minister, Rachid Mohamed, and the head of the Industrial Development Authority, Amr Assal, are facing prosecution of improperly allocating steel licenses to Ahmed Ezz's company. Charges claim that a license was given free of charge and outside the required public auction. While Turkish imports do impose a threat, Ezz enjoys significant price-setting power and controls two thirds of the steel market in Egypt. Previous charges and complaints against Ezz and the Egyptian Competition Authority were dismissed due to the limitations that such complaints endured under the previous regime against powerful figures. It is still unknown how the steel market will be shaped in Egypt. Several scenarios are likely with the most probable being the separation of Ezz Steel and Ezz El Dekhila (IRAX CA). There might also be fiscal penalties, obligatory compensation for previously state owned stacks, ownership reshuffling and other steps that the government can take.

Regulatory changes in the steel market could dampen stock performance in the medium-term.

### Prospects for Egyptian steel producers as a group still bright

From a macroeconomic standpoint, a weaker Egyptian currency will boost flat steel exports for Ezz but that is currently countered by the turmoil occurring in the Middle East which is the company's most important market. Of course, a new Egyptian government is expected to focus on infrastructure development and low-to-middle income housing which will increase demand for steel locally. While the government has changed, the population size in Egypt hasn't, and 500,000 marriages a year will continue no matter who is in power creating a need for new housing and new construction. The low mortgage penetration rate in Egypt, estimated at 0.5% of GDP compared to 1.3% for Saudi Arabia, offers further opportunity for improvement as the government passes laws to ease access to residential financing.

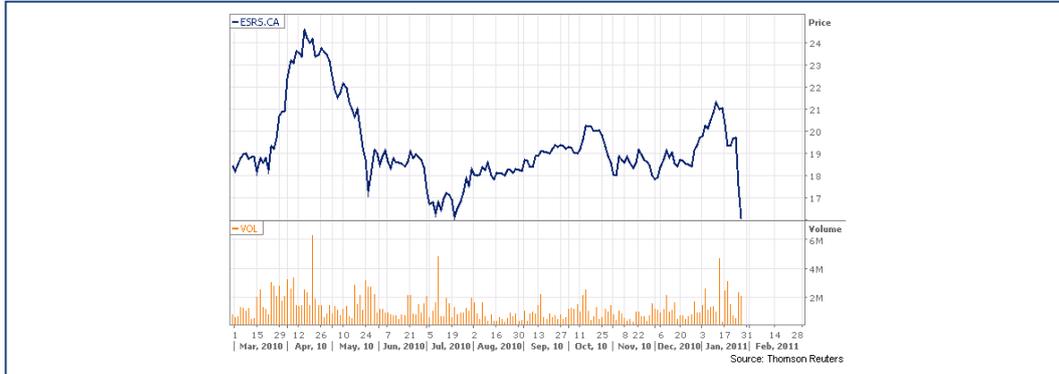
Population size and 500,000 marriages a year will continue creating a need for low-to-mid income housing and thus support steel producers.

### Share Data

|                                                     |                   |
|-----------------------------------------------------|-------------------|
| Number of Shares                                    | 543,265,027       |
| Float                                               | 35%               |
| Market Cap using Jan. 15 closing price of EGP 21.07 | EGP 11.46 billion |
| Market Cap using Jan. 27 closing price of EGP 16.00 | EGP 8.69 billion  |
| Share performance during 2 week period              | -32%              |
| Price-to-Earnings TTM using Jan.15 closing price    | 20.84             |
| Price-to-Earnings TTM using Jan.27 closing price    | 15.83             |

## Performance of Ezz Steel (ESRS.CA) during past year

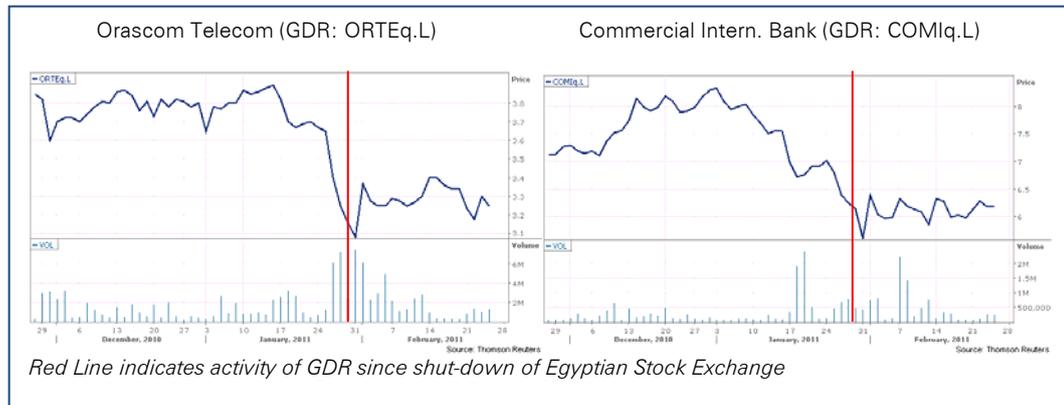
The stock has traded between a high of EGP 24.99 it reached in April 2010 and a low of 15.80 that was reached in July 2010. The last closing price before the market shut-down on January 27, 2011 was EGP 16.00 per share and we expect it to continue its decline to breach its 12-month low.



Source: Reuters

## Short-term sell-off in market is expected once exchange reopens

Since January 27, 2011, a lot has happened in Egypt that isn't yet reflected in stock prices due to the precaution taken by the government through interrupting the sell-off. Once the market reopens, investors are expecting another major sell-off in the short term followed by a mild recovery to where the price levels currently are. This is reflected in the GDRs for major Egyptian equities that trade on the London Stock Exchange and have been active while the events in Egypt unfold. Note however, that the local investor community does not have access to GDRs and are normally more informed and involved with the effect of local events. We therefore, do not feel that GDRs are fully representative of the entire investor community in Egypt but they do offer insight on the collective view regarding the severity of current events.



Source: Reuters

Once the Egyptian exchange reopens, special rules will apply so that if the index drops by a total of 5%, the exchange closes for 30 minutes. If, after the 30 minute closure, the index falls another 5%, trading will halt for the day.

As for Ezz, we believe it would encounter the same sell-off as most Egyptian large caps once the market reopens. However, instead of a possible mild recovery, allegations against its chairman and the uncertainty surrounding new industry regulations (specifically targeting Ezz Steel) should apply further pressure on the stock so that it either remains trading at the new low or perhaps even experience another 8 - 10% drop.



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## Equity Rating Key

**Buy:** A recommendation with a potential return greater than 10% based on our current 12-month view of total shareholder return\*.

**Hold:** A recommendation with a potential return between -10% and 10% based on our current 12-month view of total shareholder return.

**Sell:** A recommendation with a potential return of less than -10% based on our current 12-month view of total shareholder return.

\* Total Shareholder Return is calculated by the potential price growth over a 12-month period along with the expected dividend yield.

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